Incorporation by Professionals and The Tax Implications of Permitting the Business of a Profession to be Carried on Through a Corporation in Ontario

Two Working Papers
Prepared by
J. Robert S. Prichard and Thomas E. McDonnell
for
The Professional Organizations Committee

These working papers were commissioned by
The Professional Organizations Committee,
but the views expressed herein are those of the authors
and do not necessarily reflect the views of the
members of the Committee or of the Research Directorate.

Working Papers
#5 & #6

INCORPORATION BY PROFESSIONALS

A Working Paper prepared by:

J.R.S. Prichard
Faculty of Law
University of Toronto

AND

THE TAX IMPLICATIONS OF PERMITTING THE BUSINESS OF A PROFESSION TO BE CARRIED ON THROUGH A CORPORATION IN ONTARIO

A Working Paper prepared by:

Thomas E. McDonnell
Barrister and Solicitor

MEMORANDUM ON THE NOVEMBER 16, 1978 FEDERAL BUDGET

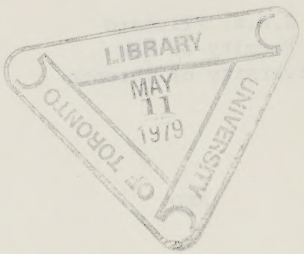
An Appendix prepared by:

Robert E. Couzin
Barrister and Solicitor

for

The Professional Organizations Committee

1978



ISBN 0-7743-3412-6

CONTENTS

TABLE OF CONTENTS

I INTRODUCTION*

This paper considers under what conditions, if any, members of the engineering, architectural, accounting and legal professions in Ontario should be permitted to incorporate.[1] As Cavitch explains, the problem in developing a professional corporations statute is that of resolving the conflict between the corporate attributes of "juristic autonomy, continuity of existence, limited liability, free transferability of ownership, and centralization of management" with the "traditional ideas of professional qualifications, discretion, relationship, standards of conduct and accountability".[2] The paper concludes that while it is possible through

---

* In addition to the helpful comments of the Professional Organizations Committee, I received valuable suggestions on an earlier draft of this paper from Professors H.R. Hahlo, Frank Iacobucci and John Quinn.

1. Canadian writing on the subject of professional incorporation is quite limited. The published works include Graschuk, "The Professional Corporation in Alberta", (1977) 25 Canadian Tax J. 109; O'Brien, "The Use of Service Corporations and the Incorporation of Professional Practices" in LSUC, The Professions (1977) pp. 127-170; MacIntyre, "The British Columbia Profes sional Corporations Act", (1972) 22 U.T.L.J. 207; Iacobucci, Pilkington and Prichard, Canadian Business Corporations (1977) pp. 85-94; Select Committee on Company Law, Interim Report (1967) (Lawrence Report) pp. 18-21; Cooper, "The Incorporation of Professionsls", (1978) 26 Canadian Tax J. 106; Flynn, "Incorporating the Professions in Alberta" (1977) 110 C.A. Magazine 32; Cader and Weinrib, "Tax Inequities of the Professional Practitioner in Ontario" (1965) U.T. Fac. L. Rev. 64; Committee on the Healing Arts, Report, Volume 2, pp. 94-95, 138, 241-242, 527; Smeltzer, "An Examination of the Professional Corporations Act in Light of the White Paper on Tax Reform", (1970) 5 U.B.C. L. Rev. 339; Rodney, "Professional Corporations", (1969) 7 Alberta L. Rev. 205; Lavine, The Business Corporations Act (1971) pp. 54-57. See also appendices to the Research Directorate's Staff Study:
A "History and Organization of the Accounting Profession in Ontario"(1978) pp.167-171.
B "History and Organization of the Legal Profession" (1978), pp. 124-130.
C "History and Organization of the Architectur Profession" (1978), pp. 165-178.
D "History and Organization of the Engineering Profession" (1978), pp. 210-213.
McDonnell, "Incorporation of Law Practices" (mimeograph, 1977); Brooks, "Professional Corporations and the Practice of Law in Ontario" (mimeograph, 1977); Furst, "Professional Corporations: Ethical Problems" (mimeograph, 1977); Ortved, "The Lawyer and Incorporation" (mimeograph, 1977); Rodney, "The Use of Professional Corporations for the Practice of Law in the Province of Alberta" (mimeograph, 1968).

2. Cavitch, Business Organizations, Volume 4A, s.82.01, p. 82-33

appropriate statutory drafting to resolve these conflicts and to devise a commercial form consistent with the fiduciary and ethical duties of the professionals, the decision as to whether or not to recommend provisions for incorporation is integrally tied to the tax implications of incorporation and their necessary distributive impacts.

The task of this paper is related to at least three other studies being undertaken by the Professional Organizations Committee. First, the study by Thomas McDonnell, "The Tax Implications of Permitting the Business of a Professional to be Carried on Through a Corporation in Ontario" analyzes the tax effects of the corporate form which are taken as given in this paper. Second, the study by John Quinn dealing with under what conditions, if any, firms comprising different types of professionals should be permitted is directly related to the issue of the need for restrictions on the beneficial ownership of the shares of professional corporations.[2a] Further, if mixed firms are permitted it seems likely, although not inevitable, that the corporate form would be the enabling vehicle. Third, the analysis of professional civil liability by Edward Belobaba will provide much of the context for the discussion of the role of limited liability in professional corporations statutes.

The approach taken in this paper is that the corporate form should reflect the conclusions reached on these related substantive issues rather than be determinative of them. Therefore, the emphasis of analysis will be to demonstrate how the corporate form might accommodate alternative substantive rules.[3]

2a. John Quinn, Multidisciplinary Services: Organizational Innovation in Professional Service Markets, Working Paper #7 prepared for the P.O.C. (1978).

3. This proposition that the corporate form should be designed so as to be neutral as to the substantive issues has not always been respected in the debate over professional incorporation. For a stark example of the contrary, see the text at footnotes 69 to 71.

This study begins with a review of the current status of the four professions in regard to incorporation, developments in Ontario and elsewhere dealing with professional corporations, and the policy positions taken at present by the four professions. The primary non-tax advantages and disadvantages of incorporation are then surveyed and evaluated. Following this, the interrelationships of the corporate form and taxation are considered with a view to specifying the peculiar problem of policy formation facing the Committee. Finally, the paper concludes with a discussion of selected problems in professional corporations including accountability, limited liability and beneficial ownership.

II. DEFINITIONS

There are three different uses of incorporation related to the business of the professions which should be identified at the outset: service corporations, professional corporations and partnerships of professional corporations.

(i) Service Corporations

Many professionals form service corporations to provide the non-professional aspects of their practices. For example, it is common for professionals to form corporations to rent the premises, purchase the furnishings and provide secretarial, administrative and management services. In addition, some accountants perform certain auxilliary services, such as management consulting and bankruptcy work, in the corporate form and some architects form development corporations to provide non-architectural services. In all these cases, the question of professional incorporation is not directly raised since

the corporations are not in the business of delivering the services for which the professional is licensed. At the same time, however, these corporations do allow professionals to enjoy many of the tax and non-tax advantages of incorporation.[4]

(ii) Professional Corporations

A professional corporation is a corporation which delivers professional services to the public. Unlike the case of service corporations, the professional corporation includes as employees one or more licenced professionals hired to provide professional services. It is often formed and owned by the employed professionals who then receive a salary from the corporation in addition to owning the equity in the firm. The professional corporation allows the professional to enjoy the full range of tax and non-tax advantages of incorporation.

(iii) Partnership of Professional Corporations

Partnership law can accommodate a partnership of corporations in addition to the usual partnerships of individuals. Therefore, if professionals are allowed to incorporate, the members of an existing partnership could do so individually and then reform the partnership as a partnership of the one-person corporations. This form of organization is attractive to the participants almost exclusively as a means of tax minimization; in a wide range of cases it will offer the professionals a more advantageous tax position than that derived from the professional corporation or the service corpora-

---

4. For an extensive review of service corporations, see O'Brien, "The Use of Service Corporations and the Incorporation of Professional Practices", LSUC Special Lectures: The Professions (1977) p. 127.

tion since it maximizes the use of the small business tax rate.[5]

This paper is primarily concerned with professional corporations. Service corporations are dealt with only incidentally as indicative of the commercial environment of the professions and the successful co-existence of professionals and corporations. The partnership of professional corporations is identified because it is the form likely to be adopted in a wide range of situations due to the magnitude of the tax saving. However, since few of the non-tax advantages of incorporation apply to the partnership of corporations, it is given only secondary attention in the paper. Therefore, in the remainder of the paper, the discussion relates to the professional corporation unless otherwise stated.

III. CURRENT POSITION IN ONTARIO

The Ontario Business Corporations Act[6] contemplates and provides for incorporation by professionals but it does not necessarily permit it. Rather, it refers to the governing Acts of the individual professions to determine whether or not incorporation is allowed. Section 3 of the Business Corporations Act states:

> 3(1) A corporation may be incorporated under this Act for any lawful objects to which the authority of the Legislature extends, except those of a corporation the incorporation of which is provided for in any other Act.

---

5. See McDonnell, The Tax Implications of Permitting the Business of a Profession to be Carried on Through a Corporation in Ontario, (1978) Working Paper #6 prepared for the Professional Organizations Committee (1978), pp. 165-169 in this volume; Flynn, supra, n. 1, pp. 33-34; O'Brien, supra, n. 4, p. 157. There is some doubt as to the validity of the partnership of professional corporations as a tax minimization scheme as it may be collapsed under the "associated companies" rule in section 247(2) of The Income Tax Act. See McDonnell, supra, p. 191.

6. R.S.O. 1970, c. 53 as amended.

> 3(3) Where the practice of a profession is governed by an Act, a corporation may be incorporated to practice the profession only if such Act expressly permits the practice of such profession by a corporation and subject to the provisions of such Act.

At present in Ontario, of the four professions under study only professional engineers have been granted the express authority to incorporate while architects, accountants and lawyers are statutorily barred from practicing in the corporate form.

(i) Engineers

Under the Professional Engineers Act,[7] a corporation, partnership or association of persons may carry on the practice of engineering if it holds a certificate of authorization issued by the Registrar of the Association of Professional Engineers of Ontario.[8] Section 20 of the Act prescribes the rules applicable to a corporation for obtaining a certificate of authorization. In summary, it requires that one of the principal or customary functions of the corporation be to engage in the practice of professional engineering and that the practice be done under the supervision of a director or full-time employee of the corporation who is a member of the A.P.E.O. The corporation must submit to the Registrar the names of the officers and directors of the corporation and the identity of the supervising members and the representative of the corporation responsible for compliance with the Act. If these requirements are fulfilled, the Registrar shall issue a certificate of authorization. Also relevant are the requirements of section 94 of A.P.E.O. By-Law No. 1 which confirms the

---

7. R.S.O. 1970, c. 366 as amended.

8. See Appendix D to the Research Directorate's Staff Study, supra n.1, pp. 210-214.

provisions of section 20 and further provides that the A.P.E.O. shall maintain a listing of all corporations holding certificates of authorization which includes the information required in an application under section 20.

As a corporation under the Business Corporations Act, a professional engineering corporation is subject to the normal range of rights, obligations, attributes and remedies including the limited liability of shareholders.[9] In addition, it is important to note that neither the Professional Engineers Act nor the By-Laws of the A.P.E.O. prescribe any requirements with respect to the ownership of the shares of the corporation carrying on the practice of engineering.[10]

(ii) Architecture

Subsection 5(2) of the Ontario Architects Act[11] prohibits the incorporation of the practice of architecture. It provides:

> No corporation shall be granted membership in the Association or be licensed to practise architecture in Ontario.

As a result, the practice of architecture is limited to a sole practice or a partnership as defined and restricted by Regulation 33 of the regulations promulgated by the Association's Registration Board.[12] Regulation 33 both

---

9. Business Corporations Act, s. 104: "A shareholder of a corporation as such is not answerable or responsible for any act, default, obligation or liability of the corporation, or for any engagement, claim, payment, loss, injury, transaction, matter or theory relating to or connected with the corporation." It should be noted that a corporation receiving a certificate of authorization is not necessarily incorporated under the Ontario Act. For example, it might be federally incorporated since the Canada Business Corporations Act, S.C. 1974-75-76, c. 33, contains no prohibition on incorporating for the purpose of carrying on a profession.

10. See Appendix D to the Research Directorate's Staff Study, supra n.1 p. 212.

11. R.S.O. 1970, c. 27.

12. Regulation 33 of the regulations promulgated by the Registration Board pursuant to section 10 of the Architects Act.

deals with the use of the architect's name and the title "architect" and creates restrictions on the forming of partnerships with non-architects. In particular, it provides that an architect may not form a partnership with a person who is not a member of the Ontario Association of Architects unless that person is a member of an "approved allied profession".[13] To date, only professional engineering has been so approved.

(iii) Accounting

Section 25 of the Public Accountancy Act[14] prohibits a corporation from carrying on business as a public accountant. It provides:

> "25(1) It is not lawful for a body corporate to practice as a public accountant and any body corporate that contravenes the provisions of this sub-section, without prejudice to any other proceedings that may be taken, is guilty of an offence and on summary conviction is liable to a fine of not less than $100 and not more than $250 for a first offence, and to a fine of not less than $200 and not more than $500 for any subsequent offence.
>
> 25(2) If a body corporate is guilty of an offence under sub-section 1, every director or officer of the body corporate who consented to, or connived at, or was responsible for the commission of the offence shall be deemed to be a party to and guilty of the offence and is liable to be proceeded against and fined accordingly."

This prohibition is confirmed by section 407 of the Institute of Chartered Accountants of Ontario's Handbook which begins: "A member shall not be associated in any way with any corporation engaged in Canada in the practice of public accounting ... ". However, section 407 then goes on to

---

13. See Appendix C to the Research Directorate's Staff Study, supra n.1, pp. 165-167.
14. R.S.O. 1970, c. 373.

modify the prohibition by providing that

> "a member may associate with a professional corporation engaged in the practice of public accounting in a province other than Ontario if such corporation is recognized and approved for such practice by the provincial institute in the province concerned".

As a result, the I.A.C.O.'s rules are sufficiently flexible that they can accommodate accounting corporations established in provinces where incorporation is permitted.[15]

(iv) Law

While there is no express prohibition against incorporation of law practices in the Law Society Act,[16] a combined reading of section 50 of the Act which restricts the practice of law to "members" of the Law Society and section 28 of the Act which defines "members" makes clear that membership is limited to natural persons and does not include incorporated bodies.[17] In addition, Ruling 29 of the Professional Conduct Handbook prohibits the use of "and company" in a firm name on the grounds that it has a "commercial connotation not in keeping with the nature of the profession".

---

15. For example, Alberta. See infra at n. 45-52.

16. R.S.O. 1970, c. 441

17. See Appendix B to the Research Directorate's Position Paper, supra n.1, p. 124. McDonnell, supra n.1, p.1. McDonnell points out that similar inferences can be drawn from the provisions of the Regulations under the Law Society Act, especially those sections dealing with the admission of members.

IV. PRIOR DEVELOPMENTS

In the past decade in Canada there has been considerable study of the issue of professional incorporation. At the same time, experience in the United States has been marked by the widespread provision for professional incorporation. These developments are reviewed briefly in this section of the paper while the following section sets out the current attitude toward incorporation taken by the four professions in Ontario.

(i) Lawrence Committee

In 1967, the Ontario Select Committee on Company Law (Lawrence Committee) studied the question of professional corporations as part of its review of the Ontario Corporations Act. It stated that:

> "The main objection of substance to permitting incorporated professional practices seems to be the apprehension of professional associations and licensing bodies that once the professional man is cloaked with the corporate form, the professional relationship between the professional and his patient or client will be impaired, if not severed, thus resulting in detriment to the public generally." 18

However, the Committee noted that exceptions to the general prohibition against incorporation by professionals were increasing and cited engineers, pharmacists and dental technicians in Ontario and the widespread use of professional incorporation in the United States as examples.[19] The Committee also recognized a number of arguments in favour of incorporation.

---

18. Interim Report, supra n. 1, p. 19.

19. Ibid, p. 18.

> There are a number of persuasive arguments in favour of permitting incorporated professional practices: carrying on a professional practice in corporate form permits clarification of the legal relationships between shareholders of the company and third parties; simplifies or eliminates difficulties arising by virtue of the withdrawal, retirement or death of members of a professional partnership; expedites transfer of interests in the practice from one person to another or to incoming members of the practice; and permits the accumulation of partnership profits for the purpose of re-investing in fixed assets or for other purposes. In addition, there are, under existing law, very real income tax advantages which would accrue to the professional person or partnership on incorporation of the practice. There seems to be no reason why all these advantages should not be available to those who are active in professional life." 20

As a result, the Committee concluded that:

> "the objections to incorporating the professional practice are unfounded and the Committee therefore recommends that the Ontario Act be amended by adding as a new Part a code of rules designed to permit the incorporation of professional service companies. It seems unrealistic to prohibit medical, legal, accounting and architectural practices, for example, from being carried on in incorporated form when at the present time such practices are in fact carried on, in some cases, in very large partnerships." 21

The Committee was of the view that incorporation of the professional practice need

> "not detract from the professional nature, attitudes and ethics of the profession, nor should incorporation mean that the professional practice would erode the valuable and traditional relationship presently existing between the professional man and his clients or patients." 22

---

20. Ibid, pp. 18-19.

21. Ibid, p. 19.

22. Ibid, p. 20.

While the Committee recommended that incorporation be permitted, it also stated the need for a special code which would set out the conditions under which it should take place so as to ensure that the professional relationship would not be adversely affected. These included:

1. The professional person should remain personally liable for his tortious acts jointly and severally with the company.

2. The professional corporation should enjoy limited liability for debts or other obligations except liabilities arising from tortious acts as mentioned in (1).

3. The particular professional service should only be rendered to members of the public by natural persons who are duly licenced to render such services.

4. The corporation's objects should be limited to carrying on the particular practice and other objects necessarily incidental or auxilliary thereto.

5. The name of the professional corporation should include some words or initials to ensure that the public is aware that the corporation is an incorporated professional practice of some kind.

The recommendations of the Lawrence Committee have not been adopted. Although, as was pointed out above, subsection 3(3) of the Business Corporations Act contemplates professional corporations, the necessary enabling provisions in the governing Acts, and the special code of conditions for professional corporations have not been enacted to date. Lavine[23] explains why the Lawrence Committee's views were rejected.

---

23. Lavine, The Business Corporations Act, (1971). The Inter-Departmental Committee Lavine refers to was the committee charged with drafting a new corporations statute in light of the Lawrence Committee's recommendations.

> "It was the opinion of the Inter-Departmental Committee that it would be unrealistic to prescribe in a statute which deals with the incorporation, operation, management and dissolution of all Ontario-incorporated business corporations general principles that would apply to all professions practised in Ontario (and the practice of which professions is governed by a specific statute applicable to each profession), where such professions are to be practised in the corporate form. Having regard to the great diversity in the existing provisions of the twenty-two statutes governing the practice of professions in Ontario, having regard to the diversity in the traditions of such professions particularly as they relate to the relationships between the persons practising them and the members of the public with whom such persons deal, and having regard to the diversity in the nature of the professions themselves, the Inter-Departmental Committee was of the opinion that the proper approach to be taken in the new Act (under which the Minister no longer has any discretion whether or not to grant incorporation) was that, if the practice of a profession which is regulated by statute is to be permitted in the corporate form, such permission should be set out in the specific statute which regulates its practice and that such statute should also set out all rules which should govern the practice of that particular profession in the corporate form, and that is what s.3(3) of the new Act provides." 24

(ii) Committee on the Healing Arts

In 1966 the Committee on the Healing Arts was appointed to enquire into and report on the regulation of the practice of the healing arts in Ontario. The issue of professional incorporation was one of the many matters dealt with in the Committee's report in 1970.[25] In particular, it

---

24. Lavine, supra n. 23, pp. 56-57.

25. Government of Ontario, Committee on the Healing Arts, Report, (Ontario: Queen's Printer, 1970).

dealt with the incorporation of the practice of medicine, dentistry and pharmacy.

With respect to the practice of medicine, the Committee adopted the views of the Lawrence Committee and recommended that physicians be permitted to incorporate their practices but that ownership of shares in such corporations be restricted to physicians licenced to practice in Ontario.[26] Similarly, with dentists, the Committee recommended incorporation subject to the same share restriction.[27] To date, there has been no legislative amendment embracing either of these two recommendations.

The Committee faced a different problem with regard to pharmacists. Prior to 1954, the corporate practice of pharmacy was permitted under the Pharmacy Act subject to the requirement that a majority of the corporation's directors be registered pharmacists.[28] However, the 1954 revisions to the Pharmacy Act added the further requirement that a majority of each class of shares of the corporation must be owned by and registered in the name of pharmacists.[29] However, this new requirement did not apply to

---

26. Ibid, Volume 2, pp. 94-95.

27. Ibid, p. 138. With respect to dentists the Committee suggested that one advantage of incorporation might be enhanced output of dental services. It stated: "We have already noted that the use of auxiliaries has increased the productivity of some dentists in recent years, and so too has the improvement of equipment and the organization of some dental practices. We have also seen how larger practices make more efficient use of ancillary personnel. The Committee believes that for this reason larger units of dental practice should be encouraged and that one means of doing this would be to relax the existing regulations which prevent the establishment of corporate practices. This appears to be warranted so long as appropriate guarantees can be maintained to ensure that professional integrity will be preserved in such practices."

28. Ibid, p. 241.

29. R.S.O. 1970, c. 295, s. 39(2).

corporations operating a pharmacy prior to 1954. The Committee was urged by the College of Pharmacy and the Ontario Pharmacists Association to recommend cancellation of pre-1954 charters which had been inactive for twelve months or more and reconsideration of existing arrangements under which non-pharmacist controlled corporations operating pharmacies can continue to exist.[30]

The majority of the Committee decided to recommend that no change be made with regard to the pre-1954 charters or the requirement of majority control applicable to post-1954 incorporated pharmacies. The Committee reasoned as follows:

> "Our studies suggest to us that the pharmaceutical industry has not been marked by strong elements of commercial competition; rather, the industry has tended to be one in which restricted entry to the trade has economic implications which may be contrary to the best interests of consumers. Thus we are not disposed to recommend steps which might limit competition in this field, nor have we heard any evidence that the pre-1954 corporate charters have been abused. It is not desirable to interfere with existing vested rights unless there is a clear reason to do so. Therefore we do not recommend cancellation of these existing charters, but only constant review of the situation by the Department of Health.
>
> On the other hand, we recognize that some danger to the public interest may be involved in any arrangement which would permit majority control of retail pharmaceutical corporations by non-pharmacists. Complete *laissez-faire* in this matter would enable literally any person or persons, entirely lacking training or professional status in pharmacy, to control pharmaceutical outlets and particpate in the drug trade. Supervision of drug

---

30. Committee on the Healing Arts, op. cit., vol. 2, p. 241.

> inventories and quality control measures might receive inadequate attention if commercial rather than professional considerations are given. Society has recognized that for the protection of the public, it is essential that pharmacists be highly trained professionals, and accordingly it has granted to pharmacists considerable powers of self-regulation and self-discipline. It would, therefore, be anomalous to permit non-pharmacists to acquire complete control of pharmaceutical outlets. We are not persuaded that it is necessary to exclude non-pharmacists from any participation in this retail trade, but we do regard as desirable retention of the present restriction regarding corporate practice so that, with the exception of the pre-1954 charters, control of pharmacies should remain in the hands of professional personnel." 31

A minority of the Committee dissented from this reasoning and conclusion, arguing that both the share restriction and the director requirement should be repealed as "it may well inhibit desirable trends in the development of pharmaceutical services, and it cannot be shown to benefit the public interest in any significant way".[32] The dissent further argued that:

> "The corporate structure in the field of pharmacy operation may easily prove beneficial in that it would accelerate the consolidation of community pharmacies into larger and more professional outlets. In view of the growing costs of establishing a professional pharmacy with an adequate inventory, the lack of initial capital may make it difficult for a younger pharmacist to acquire a pharmacy of his own, and lack of advancement possibility (other than through partnership) makes unattractive the career of a pharmacist employed by an independent

---

31. Ibid, pp. 241-242.

32. Ibid, p. 527.

> pharmacy. On the other hand, the possibility of a career in a larger pharmaceutical corporation with both managerial and senior professional possibilities may prove attractive to future pharmacists. Moreover, there are economies of scale in administration, bulk buying, inventory financing and common services which will make for a healthier pharmaceutical industry and in an active, competitive situation would be likely to produce lower prices.
>
> The fact that in five of the ten Canadian provinces there are no such restrictions on the ownership of pharmacies suggests that there is no real need for such controls." 33

In the legislative enactment following the Committee's report, the majority prevailed. Section 141 of the Health Disciplines Act, 1974[34] re-enacted the provisions of the Pharmacy Act dealing with the directors requirement and share ownership limitation.

(iii) British Columbia[35]

In enacting the Professional Corporations Act[36] of 1970, British Columbia was the first province in Canada to provide for professional incorporation as a special class of corporation. However, the Act did not have an auspicious career. In 1971,[37] its operation was suspended until 1 July, 1972. In 1974,[38] it was amended to repeal immediately the provisions authorizing new incorporations and to repeal as of 1 April, 1977 the

---

33. Ibid.

34. S.O. 1974, c. 47.

35. For a review of the British Columbia experience with professional corporations, see MacIntyre, supra n. 1; Smeltzer, supra n. 1; Iacobucci, Pilkington and Prichard, supra n.1.

36. S.B.C. 1970, c. 37.

37. S.B.C. 1971, c. 58, s. 12.

38. S.B.C. 1974, c. 67.

remaining provisions of the Act. The effect of the 1974 amendment was that all corporations incorporated under the Act were struck off the register and dissolved by 1 April, 1976. The repeal was apparently motivated by concern on the part of the provincial government that it would lose some tax revenue since the federal government's revenues would be less which would lead to a corresponding reduction in the provinces's.[39]

The Act provided that, if the governing body of a profession permitted, members of the profession could incorporate under the Act. The provisions of the Companies Act applied to professional incorporations except where inconsistent with the requirements of the Professional Corporations Act. The principal distinctions made with regard to professional corporations was that limited liability was specifically excluded.

Despite the repeal of the Professional Corporations Act, the issue of incorporation is not dormant in British Columbia. In January, 1977, the Joint Committee on Provincial Taxation[40] submitted a brief on behalf of the major professional groups in British Columbia[41] to the provincial Minister of Consumer and Corporate Affairs urging the enactment of a new Professional Corporations Act.[42] The brief argued that

---

39. See MacIntyre, supra n. 1.

40. The Committee is a joint effort of the Canadian Bar Association - B.C. Branch and the Institute of Chartered Accountants of B.C.

41. The professions included the land surveyors, architects, engineers, accountants, physicians, lawyers and dentists. (Engineers in B.C. are already permitted to incorporate with limited liability but they supported the brief.)

42. Joint Committee on Provincial Taxation, Brief on Professional Corporations (January, 1977).

> "there is no rationale for prohibiting professionals to incorporate their business activities in the same manner as anyone else who is carrying on a business, provided that sufficient safeguards for preserving the appropriate degree of professional responsibility to the community can be maintained." 43

The brief concluded that these safeguards could be devised and recommended:

> "That an Act be passed which will remove the prohibition against incorporating which exists in any specific professional act, while at the same time ensuring that professional corporations are bound by the same legal and ethical rules as those which govern individual professions and that the professional services of a corporation are performed in a competent manner.
>
> To achieve this objective, it appears essential that the performance of any professional services by a corporation be supervised by an individual who is personally qualified to render such services, and that any individual so engaged and all other officers and shareholders of professional corporations should be personally responsible for the acts of the Corporation. It is proposed that an Act should be passed permitting the incorporation of professional corporations through procedures which are virtually identical to those governing the incorporation of a company under the Companies Act, with the notable exception of limited liability. Before a corporation can go into operation, it should be required to obtain a practising permit from the governing body of the profession. The practising permit

---

43. Ibid, p. 1.

> should have a limited duration and should be subject to renewal in order to ensure continuing supervision of the conduct of professional corporations by the governing bodies." 44

As of the date of writing of this paper, no legislation has resulted from the brief.

(iv) Alberta[45]

Until a 1975 amendment,[46] the Alberta Companies Act[47] did not directly address the question of professional incorporation. However, engineers and architects were able to incorporate under the general incorporation procedures of the Act. The 1975 amendments explicitly permit lawyers, accountants, physicians and dentists to incorporate subject to a number of special conditions set out in amendments to each profession's governing

---

44. Ibid, p. 5. Although the brief called for unlimited liability, it also recognized that professions able to incorporate at present with limited liability, e.g. engineers and veterinarians, should be "free to explore that alternative separately through separate channels". It also suggested, however, that the new act would "enable any professional groups who currently are able to use limited liability companies the option of having their members incorporate under the Professional Corporations Act, so that the ability to incorporate is maintained while at the same time personal liability is unrestricted."

45. For a review of the Alberta experience, see Rodney, "Professional Corporations" supra n. 1; Iacobucci, Pilkington and Prichard, supra n. 1, pp. 87-90; McDonnell, supra n. 1, pp. 10-11.

46. Attorney General Statutes Amendment Act, 1975, (No. 2) S.A. 1975 (2nd Sess.), c. 44. This statute is reproduced as Appendix B to this paper. There has been one reported case to date dealing with the new professional corporations: see Mosier v. Mosier, (1978) 80 D.L.R. (3d) 703 (Alta. S.C.T.D.).

47. R.S.A. 1970, c. 60 as amended.

statute.[48] While there are some minor differences among the provisions of the four statutes, the conditions governing legal practices summarized below are representative.

> "The Legal Profession Act provides that to be eligible for a permit to practise law in its own name, a corporation must satisfy the Secretary of the Law Society that it is a company limited by shares and in good standing with the Registrar of Companies, that its objects include those contained in the Schedule to the Act, that its name contains the words "Professional Corporation" and complies with any rules made by the Benchers, that legal and beneficial ownership of the company's issued shares is vested in one or more active members of the Society, and that all directors and persons who will carry on the practice of a barrister and solicitor on behalf of the company are active members of the Society.
>
> If a company which meets these criteria files an application in the form prescribed by the Benchers and pays the prescribed fees, the Secretary of the Law Society must issue the permit which entitles the corporation to practise law in its own name. Such a permit is valid for one year but may be revoked if the corporation ceases to meet

---

48. Flynn, supra n. 1, p. 32, explains the background to the amendments: "In 1968 the Institute of Chartered Accountants of Alberta established an *ad hoc* committee to investigate the matter of professional incorporation. At the institute's general meeting in June, 1969, the membership approved, in principle, a resolution providing for the incorporation of accounting practices. Around the same time, representatives of the Law Society of Alberta were working toward the same end and draft legislation was soon available for presentation to the legislature.

Although the Alberta government did nothing with this draft legislation for a number of years, in early 1975 the Benchers of the Law Society of Alberta, finally got the Attorney General to ask for draft legislation for four professions: medicine, law, accountancy and dentistry. (Architects and engineers had already been able to incorporate for some years.) The legislation was passed in the midst of the expected public outcry that it was a sop to the already wealthy professionals."

the above qualifying conditions. If the corporation ceases to qualify only because a shareholder of the corporation has died or lost active membership in the Society, the corporation has ninety days within which to fulfil the condition, failing which its permit automatically terminates.

Although a professional corporation permit issued by the Law Society enables lawyers to benefit from some of the advantages of incorporation, it does not affect the liability of any shareholder or employee carrying on the practise of a barrister and solicitor. Nor does it affect his fiduciary, confidential or ethical relationships with clients or his obligation to comply with the Legal Profession Act and the Rules enacted thereunder. A shareholder of a professional corporation, who must be an active member of the Law Society, cannot enter into a voting agreement with any non-member. Further, no professional corporation can employ a suspended member of the Law Society or one whose name has been struck off the rolls except with the authorization of and subject to conditions imposed by the Benchers. Thus the corporation form cannot be used as a means of avoiding the duties and qualifications imposed on individual practitioners by the Legal Profession Act.

With some modifications, the Legal Profession Act and Law Society Rules are made applicable to professional corporations, even though they cannot be enrolled as members of the Society. A professional corporation can be disciplined for conduct unbecoming of a barrister and solicitor and be reprimanded or have its permit suspended or revoked. Professional corporations as well as their shareholders, directors, officers and employees are deemed to be subject to the laws governing fiduciary, confidential and ethical relationships between solicitor and client. The assurance fund is extended to cover misappropriation by a Society member connected with a professional corporation of money or

> property entrusted to the corporation. Provision is also made for a judge to appoint a custodian of a professional corporation when its permit has been suspended or revoked, one of its shareholders has died or become incapacitated, the corporation is unable to practise as a barrister and solicitor, a shareholder has absconded or is improperly absent, the corporation has neglected its practice for an unduly extended period, there is reason to believe that the trust moneys held by the corporation are not sufficient to meet its trust liabilities, or other sufficient grounds exist." 49

As a result of the 1975 amendments, the Alberta Companies Act now permits engineers, architects, accountants and lawyers to incorporate although the particular conditions governing the professions vary. Although no precise data is available, it appears that the Act "has been very popular and a large number of practitioners are incorporating professional corporations".[50] The Secretary of the Alberta Law Society is reported as saying that about 300 of the province's 1800 lawyers have formed professional corporations to date and that the numbers continue to increase.[51] It is further reported that most of these incorporations involve single practitioners who then form partnerships combining a number of the individual corporations.[52] As was indicated above, this form of organization is designed to achieve the maximum possible tax savings.

---

49. Iacobucci, Pilkington and Prichard, supra n. 1, pp. 88-90.

50. Joint Committee, supra n. 42, p. 2.

51. Whittingham, Financial Post, 17 December, 1977, p. 5.

52. Ibid. Also, see National, April 1978, p. 29.

(v) United States[53]

Although Canadian experience with professional corporations is limited and recent (except in engineering), the experience in the United States has been substantially broader. Primarily as a response to the different treatment of partnerships and corporations under the Internal Revenue Code,[54] all states and the District of Columbia allow all or at least specified professions to practice as corporations or associations.[55] Approximately thirty-five states have broad professional corporation or association statutes covering all professions while the remainder enumerate specified professions which may incorporate.[56]

While each professional corporation statute is a unique legislative enactment, there are a number of essentially universal features in the provisions of the various states. Cavitch describes them as follows:

---

53. There is a very substantial body of literature on professional corporations in the United States. The leading sources are Eaton, Business Organizations, Volumes 17-17D, (particularly Chapter 1, "Introduction", Chapter 3, "Non-tax Characteristics of Corporations", Chapter 8, "Ethical and Legal Status", Chapter 9, "State Statutes" and Chapter 13, "Ownership Changes and Getting Out"); Cavitch, Business Organizations, Volume 4A, Chapters 81 and 82; Note, "Professional Corporations and Associations", (1962) 75 Harvard L. Rev. 776; American Bar Association, "Professional Corporation Supplement to the Model Business Corporation Act", (1976) 32 Business Lawyer 289 and (1977) 33 Business Lawyer 929; Prins, "Accident and Malpractice Liability of Professional Corporation Shareholders", (1977) 10 U. Michigan J. of Law Reform 364. For bibliographies on professional corporations, see Eaton, Business Organizations, Volume 17D, p. B1B-1 and Cavitch, Business Organizations, Volume 4A, Chapter 81, pp. 325-327 and Chapter 82, pp. 82-1 to 82-7.

54. Cavitch, supra n. 53, s. 81.01, p. 321 states: "Professional association or professional corporation statutes have been passed in many states simply and solely to enable the self-employed professional person to share in some of the many tax benefits long afforded to employees of non-professional enterprises, particularly in the tax bonanza of qualified pension and profit-sharing plans." The treatment of professional corporations by the Internal Revenue Service followed a long and tortuous development. See Cavitch, supra, Chapter 81; Eaton, supra n. 53.

55. Cavitch, supra n. 53, s. 82.10, p. 82-18.

56. Ibid.

1. The laws and statutes of the incorporating jurisdiction and all rights, privileges, and duties applicable to other private corporations shall apply to professional corporations or associations. If such laws are in conflict with or inconsistent with the provisions of the professional corporation laws, the provisions of the professional corporation laws apply.

2. Professional people must change their own status from that of partner or proprietor to employee. In forming professional entities to obtain the retirement and other fringe benefits available to corporate employees, they must be classed as employees.

3. Individuals or a group of individuals may incorporate or associate to form a professional entity to render all of the professional services which they may perform as partners or proprietors.

4. A corporation may not issue its stock to anyone who is not duly licensed to render the same specific professional service.

5. A professional corporation may render one type of professional service only, and may only be organized for that one purpose.

6. The mixing of various professions in one corporate entity, or having ownership participation by non-professionals, is prohibited.

7. The corporate name of the professional corporation must contain such words as "professional association", "chartered", "incorporated", "professional corporation", or the abbreviations of such words. A number of statutes require that the corporate name of the professional corporation shall contain the last name of one or more of its shareholders, unless the regulating board of the ethics of a profession permit the use of a corporate name which does not include the surname of any present or former shareholder.

8. A shareholder of a professional corporation may sell or transfer his shares to only a licensed person of the same profession. Such sale or transfer usually requires the approval vote of a majority of all shareholders. Some professional statutes state that the articles of incorporation may provide specifically for additional restraints on the alienation of shares.

9. No professional corporation may render professional services except through those persons who are licensed within the state to render the same type of professional services as the corporation and who are its shareholders, directors, officers, employees, or agents.

10. The professional corporation does not modify the relationship or the liability between the professional and the person receiving the service.

11. An officer, shareholder, agent, or employee remains personally and fully liable for any negligent or wrongful acts or misconduct committed by him, or by any person under his direct supervision and control, while rendering professional services on behalf of the corporation to the person for whom such professional services were being rendered.

12. Clerks, secretaries, and other assistants are not included within the term "employees" and are not usually or ordinarily considered, by custom and practice, to be rendering professional services to the public for which a license or other legal authorization is required.

13. In most state statutes, a professional corporation may invest its funds in real estate, mortgages, stocks, bonds, and other types of investments, and may own real or personal property necessary or appropriate for rendering its professional service.

14. All the state professional entity statutes have a provision that the act's provisions shall not abolish, repeal, modify, restrict, or limit the laws in effect in that state applicable to the professional relationship and standard of conduct.[57]

There was considerable concern in the United States that, particularly with regard to the legal profession, there may be an inconsistency between the corporate form and the ethical and fiduciary obligations of professionals. However, in 1961 the American Bar Association released its watershed decision in Opinion 303[58] which held that the practice of law in corporate form did

---

57. Ibid, S. 82.01, pp. 82-31 to 82-33.

58. American Bar Association, Opinion 303 (27 November, 1961). The opinion is reproduced as Appendix C to this paper.

not of itself constitute a violation of the profession's ethical requirements.

> "Lawyers who practice law in a form of organization usually designated by a professional association or professional corporation, which has the characteristics in whole or in part, of limited liability, centralized management, continuity of life, and transferability of interests, may be, but are not necessarily, acting in violation of one or more of the Canons. The mere fact that the form of organization used by lawyers to practice law is a professional association or professional corporation does not in and of itself constitute a violation of any canon as it is the substance of the arrangement and not the form that is controlling." 59

Since this decision, the basic controversy as to the ethical proprietary of the corporate form has been clearly decided in favour of incorporation.

The prevalence of state professional corporation statutes has now led to the development of a model uniform statute, the Professional Corporation Supplement to the Model Business Corporation Act.[60] While the model provisions reflect the general characteristics of the state statutes described by Cavitch above, the Act does provide a distillation of the accumulated American experience and a consensus as to the most successful provisions. The Act deals with the definition of professional services; the objectives, activities, powers and name of professional corporations; the right of the corporation to issue, transfer and buy back its shares; the death or disqualification of a shareholder; liability of the employees, shareholders and the corporation; professional relationships and privileged communications; voting of shares; directors and officers; merger, consolidation, termination and dissolution; foreign corporations; certification and

---

59. Ibid, reproduced in Appendix C, p. 1.

60. See supra n. 53. The Model Act was drafted by the A.B.A.'s Committee on Corporate Laws and adopted by the Committee in 1977. The Act is reproduced as Appendix A to this paper.

regulation of corporations; and annual reports. A number of the specific provisions of the Act will be considered later in this paper but the whole Act would serve as a very useful point of reference were Ontario to draft professional incorporation legislation.

V. CURRENT POLICY POSITIONS OF THE PROFESSIONS IN ONTARIO

With the developments in British Columbia and Alberta and the widespread use and acceptance of professional corporations in the United States, it is not surprising that the professions in Ontario have been seeking the right to incorporate. This section reviews the developments in each of the professions in Ontario and the current positions taken by them.

(i) Engineering

The engineering profession has not articulated any need for change in the present rules governing the incorporation of engineering practices including the absence of any minimum professional ownership requirements.[61] The Association of Professional Engineers takes the position that the disciplinary powers[62] available to the Council provide sufficient control over non-professionally owned firms that ownership requirements are unnecessary.[63]

The primary concern of the A.P.E.O. regarding incorporation is that any provisions dealing with the incorporation of architectural practices not impinge on the ability of incorporated engineering practices to engage in mixed practices. The history of this concern is dealt with below in the discussion of architecture.

---

61. See Appendix D to the Research Directorate's Staff Study, supra n.1, p. 212.

62. Corporations may be disciplined (i) in the same manner as a member of the Association, (ii) by revoking the certificate of authorization, and (iii) by disciplining the individual engineers under whose responsibility and supervision the practice of engineering is carried on.

63. See Appendix D to the Research Directorate's Staff Study, supra n.1, p. 213.

(ii) Architecture

Although subsection 5(2) of the Architects Act bars incorporation of architectural practices, the Ontario Association of Architects has, for a number of years, been considering removing this prohibition. A provision to permit incorporation was one of the objectives of the revised Architects Act and since 1970 the draft Act has included a section allowing incorporation.[64] Section 15 of the draft Act states in part:

> 15. (1) Except as provided in this section, no corporation shall engage in the practice of architecture.
>
> (2) Upon application therefor in the prescribed form and upon payment of the prescribed fee, the Board shall issue or renew a licence to a corporation to engage in the practice of architecture if,
>
> (a) one of the corporations's principal or customary functions is to engage in the practice of architecture;
>
> (b) the practice of architecture by the corporation is carried on under the responsibility and supervision of a director of the corporation who is a member; and
>
> (c) the beneficial ownership of the shares of the corporation is held by members to an extent not less than set forth in the regulations.

There has been some dispute as to the exact percentage ownership required to be specified by the regulations; the Ontario Association of Architects advocated 100% but a possible compromise figure of 66 2/3% has been suggested.[65]

---

64. See History of Progress of Revised Architects Act (1976) p. 1.

65. See Appendix C to the Research Directorate's Staff Study, supra n.1, p. 167. A.P.E.O., Summary of Members' Concerns Re the Provisions of the Proposed Architects Act (1973) p.1.

It should be noted that section 15 does not modify the general rule of limited liability for the corporate form and therefore incorporated architectural practices would gain this protection from liability.

The issue of incorporation of architectural practices was canvassed in the 1974 Study of the Organization and Practices of the Architectural Profession in Ontario.[66] After noting the substantial presence of incorporated service and even development companies associated with unincorporated architectural practices,[67] the authors stated:

> "The traditional professional arguments of personal reputation and identification with the building product and "unlimited" liability and responsibility for professional errors and omissions are largely illusory. Personal liability is often limited by having few personal assets, by phrases such as 'no guarantees on cost estimates', 'contractor shall verify all dimensions', and the like, and the ultimate reference to accepted practice as carried on by professional peers. Incorporation while permitting tax advantages over partnerships for architectural firms need not negate professional responsibilities in the true sense: clients can still demand insurance or capitalization equivalent to the liabilities likely to be incurred in the project. Responsibilities for exceptional projects would have to be dealt with exceptionally under any firm structure." 68

Despite the general acceptance of the concept of incorporation for architectural practices, the provisions of section 15 of the draft Act have become the focus of the sustained jurisdictional dispute between the Ontario Association of Architects and the Association of Professional Engineers of Ontario.

---

66. Kuris and Martin, Study of the Organization and Practices of the Architectural Profession in Ontario (1974). The study was commissioned by the Ontario Association of Architects.

67. Ibid, p. 29.

68. Ibid, p. 30.

Although the A.P.E.O. "applauds the adoption of the principle of the professional service corporation" for architects as a "move which recognizes the activities and, indeed, the professional-business trends apparent today", it "cannot accept the specific translation of this principle contained in the proposed Act".[69] The A.P.E.O.'s concern arises from its interpretation of subsection 15(1) of the draft Act which it claims "would cause the break-up of all incorporated engineering firms in which architects are employed, and would effectively preclude the undertaking of architectural services by duly registered architects employed in the normal sense of the word in any corporation, engineering or otherwise".[70]

Regardless of whether such a draconian interpretation necessarily flows from the wording of subsection 15(1), two things are clear. First, the drafting of the subsection is infelicitous in the extreme if its intention is merely to enable incorporation of architectural practices and not to change the balance in the jurisdictional dispute. Second, while the share ownership requirement may well be a vehicle for achieving mixed firms, it need not stand in the way of mixed firms achieved by other means if the legislation so provides; all that is required is careful drafting of the necessary exemption provisions. It would be unfortunate and unnecessary if share ownership requirements were to frustrate the achievement of substantive developments in the area of mixed firms.[71]

---

69. Letter from C.J. Moull, President, A.P.E.O. to Attorney General, 9 November, 1973, p. 2.

70. Ibid.

71. This issue is returned to infra in section X, pp. 65-72. The debate between the A.P.E.O. and O.A.A. has now reached extreme positions. The A.P.E.O. has argued that to maintain reciprocity with section 20 of the Professional Engineers Act there should be no ownership requirement while the O.A.A. is reported as being willing to revert to its bar against incorporation to avoid the controversy over share ownership and control. See also Kuris and Martin, supra, n. 66, pp. 28-29.

(iii) Accounting

Despite the present prohibition in section 25 of the Public Accountancy Act, the Institute of Chartered Accountants of Ontario has stated "that there is no inherent objection to incorporation of a professional practice".[72] The issue of incorporation by accountants was studied in 1970 by the Special Committee on Professional Incorporation and Professional Liability.[73]

The Special Committee began its report by noting that the practice of ancillary services offered by accountants, such as management consulting and bankruptcy work, may be properly carried off in the corporate form.[74] In this regard, it observed that:

> "The experience of the Institute with management consulting firms and companies licensed to practise as trustees in bankruptcy, and the experience of the engineering profession where incorporation is in general use, would suggest that there should be no more difficulty in obtaining compliance with the rules of professional conduct for members who are associated with a corporate body as compared with those who are in practice either as sole practitioners or in partnership." 75

The Committee also reviewed and evaluated the traditional rationale for the prohibition on incorporation.

> "In following the pattern that public accounting can only be carried on as a sole practitioner or through a partnership, the profession in Ontario has been following the practice in the United Kingdom and, until recently at least, in the United States. It has also followed

---

72. See Appendix A to the Research Directorate's Position Paper, supra n.1, p. 168.

73. I.C.A.O., Report on the Special Committee on Professional Incorporation and Professional Liability (1970).

74. Ibid, p. 9.

75. Ibid, p. 13.

> the practice in the legal profession and certain other professions. The rationale for this rests with the inherent assumption that a professional man should be responsible for the professional services he renders and, in the event of negligence, his client should have the right to recover from him the damages which arose from such negligence. If one looks behind this theory to an assumption that the professional man stakes his entire financial responsibility on the quality of his performance, it could be argued that the profession should have prohibited liability insurance which can limit the financial implications to the practitioner in the event that he has been negligent in his performance. Such insurance is general, however, in all countries and in all professions, and provides additional financial security for the client so that the underlying argument for unlimited liability of the practitioner has already been very materially modified." 76

The Committee also found that concern "due to the increasing litigation and threats of litigation"[77] had led many practitioners to demand a right to practice in the corporate form with a view to obtaining some financial protection. However, the Committee pointed out that at common law the protection from liability obtained by incorporation would not free the professional man from his personal negligence but would only protect his partners in a firm from vicarious liability for his negligence.[78]

Apart from the question of liability, the Committee identified a number of advantages and disadvantages of incorporation. Among the advantages[79] the Committee cited:

---

76. Ibid, p. 9.

77. Ibid.

78. Ibid, p. 11.

79. Ibid, pp. 11-12.

1. overcoming the tax "discrimination" against sole proprietorships and partnerships as compared with corporations;

2. elimination of personal contractual liability for commercial obligations arising from the practice of the profession, e.g. leases;

3. protection of the estate of the practitioner from actions of his associates and ease of winding up the practice on the death of the practitioner;

4. provision of a "discipline" which is lacking in a partnership and the ability of the majority of shareholders to be able to exercise more effective control over an employee of the corporation than a majority of partners would be able to exercise over a partner.

A number of disadvantages[80] were also cited:

1. loss of flexibility in that directors and officers would be required, which led the Committee to believe that "many of the firms, and particularly the larger firms, would forego the advantages of incorporation in order to continue the flexibility within the partnership which they now enjoy";

2. potential tax disadvantages in addition to the tax advantages;

3. restrictions on loans to shareholders;

4. possible adverse public relations effects.

After weighing these considerations, the Committee concluded that there was "no reason why the Institute should object to its members carrying on practice in the corporate form if it is to their advantage to do so" provided that the enabling legislation ensures "that the corporate form does not make more difficult the relationship between the Institute and its members or is contrary to the public interest".[81] The Committee also recommended a number

---

80. Ibid, pp. 12-13.

81. Ibid, p. 13.

of specific conditions under which corporate practice might be permitted.[82]

1. The right to practice as a corporation should not change the professional obligations of its shareholders, directors, officers and trustees.

2. All shares of the corporation should be beneficially owned by persons who would be entitled to be a partner in the firm if it were carried on in partnership form as chartered accountants.

3. Only duly qualified shareholders or others who would be eligible to be shareholders should be directors of the corporation.

4. The corporation should not be permitted to become insolvent, insolvency defined as in section 1(7) of the Ontario Business Corporations Act.

5. In the event that a corporation should become bankrupt, each shareholder of the corporation should be subject to professional discipline as though he were personally to become bankrupt.

6. An annual return to the Institute should be required of each corporation.

The Committee also considered but rejected the possibility of including a requirement for minimum capital and/or compulsory liability insurance.[83]

Despite the Committee's recommendations and the Institute's position that there is no inherent objection to incorporation, to date no legislative action has been taken.

---

82. Ibid, pp. 13-14.

83. Ibid, p. 14. The Committee stated: "We have considered the possibility of including in such rules a requirement for minimum capital and/or liability insurance. We have rejected the former as being unnecessary at this time if the rules for financial responsibility and bankruptcy suggested above are imposed. Any requirement for a minimum capital might be unfair to the young practitioner, unless the minimum were so low as to be ineffective as protection to his creditors. So far as liability insurance being a requirement, we believe, as we have stated in Section 2 that liability insurance is desirable for all practitioners but that it should not be compulsory. The corporate form, in itself, should not affect the need to carry such."

(iv) Law

Since the report in 1967 of the Lawrence Committee, the Law Society of Upper Canada has addressed the question of incorporation three times and each time it has approved the concept.[84] Most recently, in June, 1977, the Law Society adopted the recommendation of the Special Committee on the Incorporation of Law Practices that it:

> 1. approve in principle the practice of law in this Province by professional corporations provided the personal liability and responsibility of the individual lawyer is not hereby limited;
>
> 2. refer to the Legislation and Rules Committee the question of the necessary amendments to The Law Society Act, Regulations and Rules, the Solicitors Act and Rulings of the Professional Conduct Committee to permit the practice of law to be carried on in the Province of Ontario by professional corporations; and
>
> 3. give your Committee authority to retain counsel to assist the Legislation and Rules Committee if necessary and to discuss with Revenue Canada the tax status of such corporations. 85

The first study of incorporation was initiated in 1967 in the wake of the Lawrence Committee's recommendations and it submitted its report in 1969.[86] After a brief review of developments in other provinces, the Commonwealth and the United States, they concentrated on the tax aspects of incorporation

---

84. Report of the Special Committee on Incorporation of Law Practices (1969); Report of the Special Committee on the Incorporation of Law Practices (1972); Report of the Special Committee on the Incorporation of Law Practices (1977).

85. Law Society of Upper Canada, Minutes of Convocation, June, 1977, pp. 152-153.

86. Report (1969), supra n. 84.

including pension and profit sharing plans and concluded that there were substantial potential tax savings available through incorporation. The Committee emphasized that the primary, if not exclusive, motivation for incorporation was the tax advantages and then analyzed possible competing considerations.

> "The issue may well be whether monetary tax advantages of incorporation would outweigh resulting prejudice to the professional status the lawyer now enjoys, which, to a very considerable degree, has its foundation in his personal relationship with his client. It is assumed that legislation could be drafted which would effectively impose personal liability of the lawyer-employee of a law corporation comparable to the personal liability of the lawyer today. The prejudicial consequences of incorporation are of a highly intangible nature and it is understandable that widely differing opinions will be held and expressed. With taxes playing such an extremely important part in the financial success of any business operation, any advantage that can be gained by placing the lawyer on the same basis as the business man should not be overlooked. Your Committee assumes that the shareholders of an incorporated law practice would be at all times members of the Society in good standing and believes that their personal relationship to the client and to the courts would not be affected. This seems a reasonable assumption, and if so, the major reason for not pressing for legislative recognition of incorporation is removed.
>
> . . .
>
> The tax benefits which might result from the use of a Professional Corporation flow to the lawyer. No one has suggested that the use of a Professional Corporation would result in better service to the public. On the other hand, the reasons given for opposing the use of the professional corporation include the suggestions that the public might not be so well served.
>
> . . .
>
> If the use of the Professional Corporation will not result in better service to the public, and its main purpose is to confer a

> benefit on the professionals who use it, then it should be so designed and regulated that it will not detrimentally affect the service rendered to the public.
>
> . . .
>
> The traditions of a profession should not be lightly altered. The ethical and professional standards established by generations of service demand the greatest respect. But when a professional service, which has been traditionally rendered personally, can, by statute and regulation, be rendered equally as well by corporate form, the right to use that corporate form should not be denied, if in granting it, distinct advantages flow to those who use it. On the other hand a member of our profession should not be permitted to avoid his responsibilities to his client including unlimited liability by the use of a corporate form.
>
> . . .
>
> On balance, your Committee is of the opinion that the members of the Society may obtain advantages by using a Professional Corporation. If they wish to do so, they should be given the privilege. However, that privilege should carry with it the obligation to maintain our ethical and professional standards without impairment, including unlimited liability to the client." 87

The Committee's recommendation that when the new corporations legislation were adopted, "legislation to permit the practice of law by a professional corporation (the shareholders of which would be restricted to members of the Society) under conditions that ensure the high standards of the profession"[88] be sought was adopted by Convocation in September, 1969.[89]

The Special Committee on the Incorporation of Law Practices was reappointed in November, 1969 "to consider the effect of the proposals contained in the White Paper on Taxation".[90] The Committee reported in 1972

---

87. Ibid, pp. 7-11 (with omissions).

88. Ibid, p. 11.

89. Report (1972), supra n. 84, p. 1.

90. Ibid.

that after a reconsideration of the issue in light of both the White Paper and the new Income Tax Act, it saw "nothing in the material which would affect its earlier recommendation".[91] However, the Committee made no recommendation as to when and in what manner the enabling legislation might be sought.

The question of incorporation was left in abeyance until the 1977 Report from the Special Committee.[92] The Report dealt almost exclusively with the "severe tax disadvantage vis-a-vis persons carrying on a small business or profession (e.g. engineering) in a corporate form in the Province by virtue of the prohibition against incorporation by lawyers"[93] and concluded that substantial tax savings were possible. As was noted above, the Committee recommended in favour of incorporation and its recommendation was adopted by Convocation.

Although the Committee's conclusions in 1977 were entirely consistent with the earlier studies, two details of the contemplated form of incorporation were clarified. First, the Committee clearly was considering partnerships of professional corporations. It stated: "It should be pointed out that the corporations incorporated by the individual partners in a firm would become the partners of the firm for partnership purposes."[94] Second, the Committee held out the possibility that while all the voting shares of the corporation would be held by the professional, "non-voting growth shares" might be held by members of his family.[95] These two points are returned to later in the paper.

---

91. Ibid.

92. Report (1977) supra n. 84.

93. Ibid, p. 1.

94. Ibid, p. 3.

95. Ibid.

(v) Summary

At the present time, each of the professions favours incorporation and does not believe it to be inconsistent with the public interest, although the particular recommended conditions under which it might be permitted vary primarily with respect to limited liability and beneficial share ownership. The engineers and architects envision full limited liability, the accountants a modified form of limited liability and the lawyers unlimited liability. With respect to beneficial ownership of shares, the engineers support no professional ownership requirement while the architects seek a 66 2/3% requirement and the accountants and lawyers would require 100% professional ownership, at least of voting shares.

VI. PRIMARY NON-TAX ADVANTAGES AND DISADVANTAGES OF INCORPORATION

The four professions' support of allowing incorporation of professional practices is clear evidence that there are some net advantages to incorporation. The difficulty, however, is to determine the nature of these advantages and to whom they are likely to accrue. In particular, if the advantages are primarily in the form of tax savings to the individual professionals, it is difficult to arrive at any decision as to the public interest in the incorporation issue (as opposed to the private interests of the professionals) without addressing the wealth distribution implications of the decision. Therefore, this section of the paper delineates the primary non-tax advantages and disadvantages of incorporation while the following section adds the tax aspects of incorporation and their implications for policy formation. The non-tax considerations are reviewed by examining the traditional attributes of incorporation and their applicability to professional corporations.[96]

---

96. This methodology is suggested and used by McDonnell, supra n. 1, p. 6.

(i) Advantages

It is important to recognize at the outset that many of the professional practices are substantial business undertakings vitally involved in commercial activity. While recognizing and respecting their professional responsibilities and aspirations, practitioners of the four professions are engaged in important and often competitive entrepreneurial activity. Given that in almost all other spheres of commerce and entrepreneurship the corporate form is the most common entity for carrying on business, it should be expected that the corporate form will offer certain advantages to the professional firm. Some of these potential advantages are described below.

(a) Continuity of Existence

A corporation has a perpetual existence in the sense that it is not terminated upon the death or retirement of one or more of its owners since as a statutory creation it has an existence independent of the individuals participating in it. This continuity of existence may in a variety of settings accord with the expectations of the clients of the firm and as such represent an advantage. However, in view of the flexibility which can be obtained from a properly drawn partnership agreement, the advantage would not appear to be significant.[97]

(b) Centralization of Management

The requirements of the Business Corporations Act dealing with the election of directors, the appointment of officers and the allocation of management responsibilities may formalize the decision-making structure of a firm which incorporates. The statutory allocation of managerial responsibilities may clarify relationships within the firm and enhance the internal

---

97. See McDonnell, supra n. 1, p. 8.

control and discipline mechanisms of the firm. Again, however, as with continuity of existence, these same advantages can be achieved through careful drafting of a partnership agreement. The difference lies in the fact that the corporations statute demands the formality while partnership law merely facilitates it. At the same time, it should be recognized that the corporate form may lead to a loss of flexibility in structuring decision-making and may thus be a mixed blessing.[98]

(c) Limited Liability[99]

As a general rule, a corporation as a separate legal entity is only liable to the extent of its assets. That is, a person seeking to enforce a debt, judgment or other obligation against a corporation may succeed only against the assets of the corporation and in this sense the corporation and its shareholders enjoy limited liability. A shareholder of the corporation is not as such liable for the obligations incurred by the corporation and therefore his liability is limited to the extent of his investment in it.[100]

Regarding negligent acts by shareholder/employees of a corporation, the individual shareholder/employee is personally liable for his torts to the extent of his personal assets and the corporation is vicariously liable for the shareholder/employee's negligent acts to the extent of its assets. Therefore, while a shareholder/employee remains liable for his own negligent acts or advice (and that rendered under his supervision), he is not personally

---

98. For example, courts have imposed limitations on the extent to which a shareholders' agreement can fetter the discretion of the directors. See Iacobucci and Johnston, "The Private or Closely-held Corporation" in Ziegel, 2 Studies in Canadian Company Law (1973) 68 at page 110 ff. However, see Iacobucci et al., supra n. 1 at pp. 161-163 for a discussion of shareholder agreements and the potential for statutory flexibility. Furthermore, see the statutory provisions for unanimous shareholder agreements under section 140 of the Canada Business Corporations Act.

99. For a brief introduction to limited liability, see Gower, Modern Company Law (1969) pages 71-73.

100. Business Corporations Act, s. 104.

liable for the acts of other shareholder/employees of the corporation. By way of contrast, in a partnership, every partner is jointly and severally liable for the negligence of his fellow partners since each partner is the agent of all the others in carrying on the normal business of the firm.[100a]

As a result, the liability of the participants in a professional firm is less extensive if the business is carried on in the corporate as opposed to the partnership form. The essential reduction lies in the elimination of the personal liability of the shareholders of the firm for the tortious acts of the other shareholder/employees.

This net effect, known as limited liability, is sometimes offered as an advantage of incorporation. It is said that limited liability encourages risk taking and entrepreneurship by relieving the owners of some of the risks of the enterprise. Further, as will be argued below, the limited liability feature of the corporate form facilitates the development of efficient capital markets for corporations with widely distributed shareholdings.

The advantages and disadvantages of limited liability are addressed at some length later in this paper. For present purposes it is sufficient to state that as a matter of theory, only in the case of corporations with widely distributed shareholdings can a persuasive case be made for limited liability as a statutory presumption accompanying incorporation. As a result, while incorporation traditionally carries the assumption of limited liability, this can only be offered as an advantage from a public interest perspective in the case of widely-held corporations, a form of organization not likely to be associated

---

100a. See Partnerships Act, R.S.O. 1970, c. 339 ss. 10 and 11.

with at least some of the professions. In addition, it should be emphasized that to the extent limited liability is desired as a way of assigning certain risks to the creditors or clients of professional firms, this assignment can be achieved by contractual arrangements determining the extent of liability.[100b]

(d) Transferability of Interests

The admission and withdrawal of members of the firm arising from purchase, sale, death or retirement may be facilitated by the corporate form as equity shares in the corporation could provide a readily transferable interest. However, three limitations on the magnitude of this advantage should be noted. First, a partnership agreement can create a mechanism for transfer of interests very similar to that obtained by purchase and sale of shares. Second, the mere existence of shares does not overcome the sometimes difficult problem of valuation of the interest in the firm. Unless there is a developed market for the shares (a condition unlikely to be fulfilled if there are substantial constraints on beneficial ownership), the valuation problem is not likely to be any easier in the corporate form than the partnership form.[101] Third, in a range of situations, the transfer of interests through the corporate repurchase of shares may have disadvantageous tax implications and as a result its frequency of use may be limited.[102]

100b. With respect to clients of professional firms, the ability to assign risks contractually is somewhat clouded by the continuing confusion as to the nature of professional civil liability. See Nelson, "The Source of Professional Liability: Tort or Contract?" in LSUC, Current Problems in the Law of Contract (1975), p. 323.

101. While the problem of valuation is not overcome by incorporation, the marketability of the shares may be enhanced. Assuming that the professional corporation would be permitted to repurchase its own shares subject to the usual limitations regarding creditor and shareholder protection, the corporate form permits the firm itself to become a potential purchaser of the interest being transferred.

102. See McDonnell, supra n.1, p. 8.

(e) Received Financial Instruments

A professional firm may be able to reduce the costs of raising either debt or equity capital from lay investors if it is organized in the corporate form. Corporations legislation offers a sophisticated array of financial instruments to accommodate both debt and equity investments, the full range of which may not be readily accessible to a partnership. The magnitude of this advantage depends, of course, on the manner in which the firm's practice is financed and the extent to which the firm is permitted to rely on non-professional sources of capital.

(f) Facilitation of Commercial Dealings

As business enterprises, professional practices must engage in a range of commercial relationships including entering leases, agreements for support services and contracts of employment with non-professional staff. The corporate form may in some circumstances facilitate and simplify these commercial dealings and thus offer some savings in transactions costs.

(g) Compensation Systems

The corporate form creates the potential for a wider range of compensation schemes since employer-supported health plans, life insurance, deferred profit sharing pensions and loans for employees gain preferred taxed treatment not available to a partnership.[103] Although much of this advantage should be classified as purely a tax advantage, it is at least plausible to suggest that the greater range of compensation packages available may allow more creative design of compensation schemes, thus sharpening incentives and heightening productivity.[104]

---

103. See O'Brien, supra n. 1 at pp. 158-159.

104. The same argument might be made with regard to estate planning techniques which may be facilitated by the corporate form.

(h) Offshore Projects

It has been reported that some architectural firms have been denied access to some overseas markets by virtue of their inability to incorporate.[105] The bar has arisen where the foreign client demands that the firm be incorporated as a prerequisite to the firm being considered as a supplier. Although the client's motivation for such a requirement is not altogether clear,[106] to the extent it exists,a barrier to the Ontario firms is being created which could be eliminated by professional corporations legislation.[107]

(i) Differential Access to Incorporation

The elimination of differential access to incorporation by means of general professional corporations legislation could avoid certain distortions in the development of multi-disciplinary firms. Quinn explains:

> "The differential treatment of the incorporation privilege among the four professions has the indirect effect of impeding multi-disciplinary practice. For example, engineers enjoy the privilege of corporate practice, while architects do not. As a result, an engineer who wishes to engage in multi-disciplinary practice with architects must sacrifice the benefits of corporate practice; if the incorporation privilege entails substantial tax or other business advantages, the engineer is deterred from multi-disciplinary innovation beneficial to consumers."

However, Quinn goes on to point out that this is not necessarily a compelling reason for allowing professional incorporation.

> "It should be emphasized that this multi-disciplinary practice dimension of the incorporation issue does not necessarily devolve into an argument favoring universal extention of the incorporation privilege; it is merely an argument for equal treatment, which

---

105. Confirmed in a telephone conversation with Mr. Brian Parks of the Ontario Association of Architects.

106. One possible explanation is that the foreign client uses the corporate form as a proxy for size and stability of the firm and thus relies on the incorporation requirement as a preliminary screening of potential suppliers.

107. It may be that some firms have been able to circumvent the restriction on incorporation in Ontario by incorporating elsewhere and/or by associating themselves with an incorporated firm in another jurisdiction. However, there is no evidence that this is so and even if it is, inefficiency is being created by the need for these avoidance techniques.

> could be accomplished by withdrawing the privilege from groups who currently possess it. Moreover, the adverse impact from the differential extention of the privilege could be minimized by ensuring that professions with closely related or complementary functions receive equal treatment. Thus, uniform treatment among architects and engineers would be desirable, but differential treatment between architects and lawyers is unlikely to impede any significant multi-disciplinary activity, at least in the near future." 108

(ii) Disadvantages

The disadvantages of professional incorporation have both tax and non-tax aspects. Consistent with the review of the advantages, only the non-tax considerations are dealt with in this section.

(a) Loss of Flexibility

Concomitant with the formalization of the firm induced by the corporate form is a loss of flexibility in the organization of its affairs. The corporations statute dictates certain minimum requirements as to the organization of the firm and thus denies the owners some of the flexibility associated with a partnership. Additionally, the allocation of shares of income within the firm as circumstances change may become substantially more difficult necessitating at a minimum a sophisticated share structure or some provision for issuing additional shares.[109] Also, in the corporate form, the firm is arguably more difficult to dissolve than when carried on as a partnership.

(b) Costs

Incorporation involves a range of increased costs both at the point of incorporation and on an on-going basis. The formation of the corporation will involve both incorporation fees and legal fees. The latter may be quite

---

108. Quinn, supra n. 2a, pp. 65-66.

109. McDonnell, supra n. 1, p. 9. McDonnell notes that this problem is not faced in the partnership of professional corporations alternative.

significant for a large firm as the formulation of a basic plan and the drafting of the enabling documents are likely to be substantial tasks. On an on-going basis, the incorporated firm will face increased costs for annual reports and returns, additional administration, withholding at source of income taxes, Unemployment Insurance premiums and Canada Pension Plan contributions, and additional legal and accounting services.

(c) Inconsistency with Professional Obligations

It has been suggested by some commentators that the overwhelming disadvantage of professional incorporation is that it is inherently inconsistent with a professional's obligations and duties. At the level of image, it might be argued that the corporate form would represent an undue commercialization of the professions which are more than "mere money-getting trade[s]".[110] Although this view may have had some validity at an earlier time, in the present professional environment it seems tenuous in the extreme to argue that the form of organization will somehow be determinative of the professions' images or actions. Given that each of the professions under study operates vigorously and centrally in the commercial environment and utilizes corporations to provide support and ancilliary services, the extension of the corporate form to the professional services should not of itself be cause for alarm.

A more substantial concern relates to whether the corporation might constitute a barrier between either the professional and his client or the professional and his governing authority. With respect to the client, it might be feared that the corporate form would dilute the professional/client relationship and associated privileges. With regard to the governing body, it might be feared that the corporate veil would create a bar to effective control over the individual professional.

---

110. Law Society of Upper Canada, Professional Conduct Handbook cited in H. Allan Leal, "The Regulation of the Professions: The Professional Organizations Committee of the Attorney General of Ontario" in LSUC, Special Lecture, 1977, (Toronto: Richard DeBoo Ltd., 1977).

These concerns have been considered and, in my view, met by appropriate drafting of professional corporations legislation. For example, the Alberta legislation governing incorporation of legal practices provides:

> 118 (1) Nothing contained in section 113 shall affect, modify or limit any law applicable to the fiduciary, confidential or ethical relationships between a barrister and solicitor and a person receiving the professional services of a barrister and solicitor.
>
> (2) The relationship between a professional corporation carrying on the practice of a barrister and solicitor and a person receiving the professional services of the corporation is subject to all applicable law relating to the fiduciary, confidential and ethical relationships between a barrister and solicitor and his client.
>
> (3) All rights and obligations pertaining to communications made to or information received by a barrister and solicitor, or his advice thereon, apply to the shareholders, directors, officers and employees of a professional corporation. 111

Furthermore, the legislation provides that both the individual practitioner and the professional corporation are subject to licensing and discipline by the Law Society.[112]

These issues of accountability and discipline are returned to below. Suffice it to say at this stage of the analysis that, with appropriate statutory drafting, no substantial disadvantage from the perspective of the public interest can be attributed to an alleged inconsistency between the corporate form and professional obligations.

---

111. Attorney General Statutes Amendment Act, S.A. 1975, c.44, s.118.

112. Ibid, ss.111-113, 121. For similar provisions in Ontario, see for example the regulation of land surveying under The Surveyors Act, R.S.O. 1970, c.452, particularly ss.26 and 29.

(iii) Summary

The striking feature of the non-tax advantages and disadvantages of professional incorporation is how relatively inconsequential they appear to be. While the disadvantage of professional incorporation can, by appropriate statutory drafting, be limited to the loss of flexibility and the start-up and on-going costs associated with a corporation, the corresponding advantages are also not of great moment. Many of the alleged advantages of incorporation including continuity of existence, centralization of management and transferability of interests can be attained through a sophisticated partnership agreement.[113] The primary advantage of incorporation in this regard must lie in the fact that in a corporation these attributes are statutorily dictated while in a partnership they arise only from the contractual agreement of the partners.

Some of the other advantages of incorporation may be of more substance although their magnitude is likely to vary with the nature of each of the professions. The primary advantages are access to received financial instruments, elimination of barriers to offshore activities, limited liability and elimination of differential access to incorporation. For example, in the legal profession each of these alledged advantages would be of little, if any, relevance; law firms do not generally require large injections of capital, do not face offshore barriers that would be overcome by incorporation, do not have widely distributed ownership thus justifying limited liability and are not likely discouraged from multi-disciplinary practice given that accountants also lack the incorporation privilege.

---

113. It should be conceded, however, that for very large firms, the drafting of the partnership agreement may become difficult and complex. On the other hand, to the extent that a firm which incorporates wishes to maintain individual rights and responsibilities similar to those in a partnership, an equally difficult and complex shareholders agreement will likely be required.

The relevance of the advantages of incorporation to the accounting profession are somewhat more problematic than for the legal profession. The primary difference between accountants and lawyers from a structural point of view is that the largest accounting firms, integrated nationally and internationally, are substantially larger than the largest law firms. As a result, if accounting firms were extended the privilege of limited liability and access to received financial instruments, some structural innovation might be expected. However, the importance of these innovations and the magnitude of their implications for consumer welfare are necessarily speculative.

Engineering and architecture present a different case. Here the offshore barriers have been demonstrated as a real disadvantage and the differential access to incorporation is likely to create distortions in the creation of multi-disciplinary firms. Additionally, at least with regard to engineering, the market has produced a number of large firms with widely distributed ownership providing engineering services and for these firms the privilege of limited liability and the access to received financial instruments are of significance.

It should be stressed at this point that the analysis of advantages and disadvantages has concentrated on the professional corporation and not on the partnership of professional corporations. If the latter were the focus of analysis, it is clear that most, if not all, of the alleged advantages of incorporation would be undermined while the disadvantages in terms of costs and loss of flexibility would be enhanced. As was noted above, the sole motivation for this form of organization is to maximize tax savings and it cannot be credibly argued that non-tax advantages would be forthcoming. Thus, the case for permitting partnerships of corporations becomes a question of taxation and its distributive effects. As such, it will be considered in the next section of the paper.

In sum, it appears that while for some firms, particularly in the engineering and architectural professions, the corporate form will offer non-tax advantages, these advantages will not often be of great magnitude and for many firms may be outweighed by the loss of flexibility and increased costs associated with incorporation. Therefore, if there were no other considerations to be brought to bear on the decision, the public interest would be enhanced by permitting professionals to incorporate subject to conditions designed to minimize any possible public interest disadvantage. Under such enabling legislation, individual firms of professionals would presumably decide whether or not to incorporate after an assessment of the competing advantages and disadvantages and their decision could, on balance, be presumed to be consistent with the public interest.

Unfortunately, this analysis is incomplete; it assumes that only non-tax considerations will influence the individual firm's decision of whether or not to incorporate. Clearly, in an environment of significant differential tax treatment of partnerships and corporations, the non-tax considerations will be supplemented, and indeed often dominated, by the tax considerations. Therefore the next section of the paper turns to an analysis of the effect of this differential tax treatment and its implications for policy formation.

VII. TAX ASPECTS OF INCORPORATION AND THEIR IMPLICATIONS FOR POLICY FORMATION

In his paper he prepared for the Committee, Thomas McDonnell analyzes the tax implications of professional incorporation.[114] He concludes that in

---

114. McDonnell, The Tax Implications of Permitting the Business of a Professional to be Carried on Through a Corporation in Ontario, Working Paper #6 prepared for the Professional Organizations Committee (1979), following in this volume.

a wide range of circumstances (but not all) the professional is able to reduce his tax liability by incorporating and that these savings can be increased if non-professional persons are permitted to acquire shares in the professional corporation. He further concludes that for medium and large size firms, "the tax advantages of incorporation may be limited to the more generous deferred income arrangements that are available" since "current savings in tax are likely to be small because of the early elimination of the low rate available on up to $750,000 of active business income".[115]

These tax implications of incorporation complicate the analysis developed in the preceding section in two ways. First, the tax consequences of incorporation may dominate the decision of whether or not to incorporate and thus the balancing of non-tax advantages and disadvantages postulated in the preceding analysis may be distorted in ways contrary to the public interest. Second, the reduction in tax liability accompanying incorporation offers the possibility of a substantial distributive gain for members of professions not at present able to incorporate and this distributive effect must be considered in identifying the public interest in professional incorporation.

(i) Distortion of the Incorporation Decision

The distortion of the incorporation decision arises in situations where although the balance of the non-tax advantages and disadvantages weighs against incorporation for an individual firm, the attractive tax consequences of incorporation dictate a decision to incorporate. That is, in some

---

115. Ibid, p. 164. It should be noted that the partnership of professional corporations device is designed to respond to this limitation since each corporation within the partnership is then able to take advantage of the low rate available on the first $750,000 of active business income.

situations, a firm will incur the net non-tax disadvantages of incorporation (higher costs, less flexibility, etc.) in order to obtain the tax advantages. This will not, of course, always be the case. In those situations where the non-tax considerations dictate incorporation, the advantageous tax treatment of the corporation will merely confirm the decision.[116]

In those situations where the tax and non-tax considerations are competing and the tax effect outweighs the non-tax advantages, the decision to incorporate would not be in the public interest. Real efficiency losses would be incurred in the form of higher costs and loss of flexibility associated with incorporation to be offset not by efficiency gains but only by the reduced tax liability enjoyed by the firm. Since the tax savings arise not from any underlying economic efficiencies but rather from the differential tax treatment of corporations and partnerships, the individual professionals may be better off but society, at least in terms of efficiency, is worse off.[117]

While important, this point should not be overstated. First, the distortion arising from the absence of tax neutrality between partnerships and corporations is not unique to professional incorporation; it will arise in all commercial situations where the tax and non-tax considerations are competing. Second, the magnitude of the inefficiency generated by the distortion is probably very limited since the net non-tax disadvantage of incorporation is likely to be relatively small. Third, the frequency with which the distortion occurs, at least with regard to some of the professions,

---

116. There may be some situations where non-tax considerations dictate incorporation while the net tax implications may favour the partnership form. However, my understanding of McDonnell's paper is that this would be a relatively rare situation.

117. To the extent that tax savings are realized by firms which incorporate, the market may force some sharing of these savings with clients in the form of reduced prices. However, even if this is the case, no efficiencies have been created since the savings arise only from the differential tax treatment.

may not be great since the balance of the non-tax considerations will often be positive, even if only slightly so.

Although the distortion may be slight it is inevitable in the absence of tax neutrality. In the absence of tax reform, the incorporation option cannot be provided without simultaneously inviting the potential distortion of the differential tax treatment. Given the option of incorporation, its utilization will be determined by the combined tax and non-tax effects of incorporation as assessed by the individual firms.

A partnership of professional corporations can best be understood in light of this distortion. As was noted above, the balance of non-tax considerations will almost certainly be negative in the great majority of cases using this form of organization. However, the advantageous tax treatment available to the partnership of professional corporations[118] will likely outweigh the non-tax considerations and result in firms opting for this form.[119] In these situations, the case for permitting professional incorporation must be based on distributive grounds since on efficiency grounds the case would appear to be at best uncertain and at worst lost.

(ii) Distributive Considerations

The reduction in tax liability for professionals in a wide range of financial circumstances consequent upon incorporation offers the possibility of a substantial distributive gain for professionals not at present able to incorporate. As a result, the Committee must consider this positive effect on professional incomes in formulating recommendations regarding incorporation.

---

118. See supra n. 115.

119. The Alberta evidence, supra n.52 would appear to confirm this while the Law Society of Upper Canada's 1977 report, supra n. 84, page 3, assumes it will happen if incorporation is permitted.

At one level of analysis it is difficult to argue that a substantial increase in professional incomes would promote the public interest. In a society with a general commitment to reducing wide disparities in the distribution of wealth, a policy recommendation which will have the effect of enhancing the financial position of groups which have traditionally been relatively well endowed seems hard to justify in the absence of other countervailing considerations. Two such competing considerations can be identified.

The first is that the distributive impact is an inevitable adjunct to a policy which is desirable on efficiency grounds and that to the extent an undesired distributive impact occurs, it can be eliminated by appropriate tax measures. The thrust of the preceding section has been to demonstrate that this argument is not of great force with regard to at least some of the professions since the potential efficiency gains appear to be small, and in a range of situations, inefficient results are likely to occur. However, if an alternative conclusion were reached as to the magnitude of the efficiency gains, it might be desirable to permit incorporation on these grounds despite the distributive impact.

A second consideration which might support a decision despite its conflict with general values regarding the distribution of wealth is fairness, or more technically, "horizontal equity". Horizontal equity demands that persons in essentially the same position should be treated in the same way for tax purposes. Therefore, the argument states that since professionals are engaged in business the same tax opportunities available to businessmen generally should be extended to professionals. Given that businessmen have the freedom to choose whether to use the partnership or corporate form after an assessment of all the advantages and disadvantages, tax and non-tax, that same freedom should as a matter of equity be extended to professionals in

the absence of compelling arguments to the contrary. Put more narrowly in the context of this paper, given that engineers are able to incorporate and obtain the advantageous tax treatment, does equity not demand that the privilege be extended to the other three professions?

The persuasiveness of this case depends on two further considerations. First, should the category of persons entitled to equal treatment be defined as businessmen generally, including all professionals, or should we be more refined in the definition of groups? While the broad definition may be attractive, it is quite plausible to argue that professionals, particularly those in the higher income professions, should be considered as a category for purposes of equity or even that each profession should be treated as a separate category. For example, while it would be inequitable to allow a subgroup of the legal profession an advantageous tax arrangement denied to other members of the profession, the dictates of horizontal equity may be met by extending equal treatment to all lawyers. If this latter argument is accepted, then a different tax treatment of businessmen and professionals is not inconsistent with at least one definition of horizontal equity.

There is no ready answer to this dilemma. The presence or absence of fairness depends on a judgment as to the appropriate breadth of the definitional categories and this judgment in turn depends on one's resolution of the conflict between horizontal equity and broader questions as to the appropriate distribution of income.

The second consideration relating to arguments of equity and their implications for whether or not to permit incorporation relates to the appropriate allocation of policy-making responsibility in this area. The difficulty arises from the inevitable interaction of policies being formulated by distinct specialized institutions. On the one hand, the Committee

must take a position on incorporation while being forced to accept the tax implications of that decision as determined by another institution. On the other hand, the taxing authorities[120] must formulate the tax statutes based on some assumptions about the organization of commerce, in particular whether or not professionals may incorporate. Each institution must react to the environment created by the other in carrying out its specialized tasks. In this particular situation, the policy problem is complicated by the constitutional division of responsibility as the Committee as a provincial institution must operate in the environment created by an essentially federal institution.

The traditional response to this dilemma is to instruct each institution to pursue its specialized mandate assuming that all other institutions will successfully fulfil their individual mandates. Therefore, the Committee with responsibility for reviewing the regulation of the professions and no mandate for tax matters should formulate its recommendations assuming tax neutrality. Similarly, the taxing authorities should pursue their mandate of an equitable and efficient tax statute taking account of changes in circumstances in the commercial environment such as which groups are able to incorporate.

While this view of specialized responsibilities certainly eases the task of a particular policy-making institution, it may ignore at least two important factors. First, in its extreme form, it assumes a probably unrealistic degree of refinement in institutional interaction. That is, the view assumes that each institution will respond expeditiously to environmental changes caused by other policy-making institutions so as to ensure that its mandate is fulfilled on a continuous basis. Given technocratic and bureaucratic imperfections, it may at times be incumbent upon specialized institutions to

---

120. The terms "taxing authorities" and "taxing institutions" are used loosely to designate the amalgam of institutions responsible for tax statutes.

consider the probable actions (or lack thereof) of other institutions in formulating their policy recommendations.

The second related factor bearing on institutional specialization is the question of onus. That is, a change in policy by one institution may shift the onus for changing a policy from an interest group to another institution. In the case of incorporation, if under the present regulatory regime the professions wish to be treated for tax purposes on the same basis as corporations, the professions must bear the onus of persuading the tax authorities to change their present policies. In fact, the Law Society of Upper Canada considered seeking such a change and concluded that it would be futile.[121] However, if the Committee were to recommend that the professionals be permitted to incorporate and this recommendation were enacted, the professionals would receive their desired tax treatment unless the taxing authorities initiated a change in their policies so as to neutralize the effect of incorporation. Thus, the onus for seeking a change will have shifted from the professions to the taxing authorities and the effect of the onus may be substantial in determining the policy outcome.

(iii) Summary and Conclusions

In sum, the presence of substantial tax effects accompanying incorporation significantly complicates the task of the Committee in formulating a recommendation regarding incorporation. The absence of tax neutrality may introduce an inefficient distortion to the decision of whether or not firms would incorporate. Furthermore, permitting incorporation would, in the absence of remedial action by the taxing authorities, result in a substantial

---

121. Report (1969) supra n. 84, p. 7.

distributive benefit for many members of the four professions which may be contrary to a general commitment to reducing wide disparities in the distribution of wealth. As a result, the Committee must consider the extent to which it should assume a specialized role inthe policy formation process and the manner in which it should respond to the distributive impact of its recommendations.

On the distributive question, the author's personal biases can have no special claim to relevance and thus will not be offered. The purpose of this section of the paper has been to identify the tax implications as perhaps the primary motivation for and result of permitting incorporation and to urge the Committee to consider them in formulating its recommendations. Presumably the resolution of this issue cannot be reached in isolation but rather must be found as part of the total calculus of reform in the regulation of the four professions.

In my view, the only unacceptable approach for the Committee to take would be to ignore the distributive implications of its decision. The question of incorporation by individuals is and will remain an issue with substantial tax implications and policy recommendations cannot be reasonably formulated without reference to this reality.

It is perhaps useful to note that at least some of the professions themselves have recognized the primacy of the tax implications. As the Law Society of Upper Canada frankly stated in its 1969 report:

> "The tax benefits which might result from the use of a professional corporation flow to the lawyer. No one has suggested that the use of a professional corporation would result in better service to the public." 122

---

122. Ibid, page 10. See also McDonnell, supra n. 1, page 6: "It is frankly conceded that the principal benefits of incorporation are of a tax nature"; I.A.C.O. Report (1970), supra n. 73, page 11; Appendix C, supra n. 1, page describing the draft Architects Act: "The provision for incorporation was inserted in the new Act so as to enable OAA members to enjoy certain tax benefits." The LSUC's 1977 Report, supra n. 84, deals almost exclusively with tax aspects of incorporation.

VIII. INTERIM CONCLUSIONS

The analysis to this stage leads to the following conclusions. First, the net non-tax effects of permitting incorporation would be positive although probably not substantially so. Second, the magnitude of the non-tax efficiencies would vary from profession to profession depending on a number of factors which have been identified. Third, assuming tax neutrality, the Committee should favour permitting incorporation by professionals so that these efficiencies could be realized by those firms for which the net effects would be positive. Fourth, this conclusion relates only to professional corporations and is inapplicable to a partnership of professional corporations. Fifth, once the assumption of tax neutrality is relaxed, the differential tax treatment of corporations and partnerships adds another dimension to the incorporation issue. Sixth, the differential tax treatment would in some cases both distort the choice of form of business organization and create significant distributive gains for incorporated professionals. Seventh, the formulation of a policy recommendation regarding incorporation must include both the efficiency and distributive implications and must do so within the total framework of reform of professional regulation.

Given the above, the Committee may well resolve the issue by favouring legislative amendments to permit incorporation by architects, accountants and lawyers and to retain incorporation by engineers. If this is the case, the recommendation should be contingent upon the enabling legislation being drafted so as to maximize the access to the potential non-tax advantages of incorporation without creating any conflict with the fiduciary and ethical duties of the relevant professionals.

As was stated at the outset of the paper, a review of the Canadian and American experience with professional corporations indicates that a statute can be drafted to create a corporate form consistent with professional practices. Fortunately, experience in other jurisdictions and in the engineering profession in Ontario can be looked to as a guide to proper statutory drafting. In particular, the recent Alberta legislation[123] and the American Bar Association's Professional Corporations Supplement to the Model Business Corporation Act[124] offer very useful models to ensuring the consistency of the corporate form and professional practices.

As a result, this paper will not review in detail the various provisions which would be required to draft a comprehensive professional corporations statute. This task can best be accomplished by the normal legislative drafting process subject to specific recommendations the Committee may wish to make. Therefore, the remainder of the paper will concentrate on three issues which, in my view, warrant particular attention and direction by the Committee: (1) accountability and discipline; (2) beneficial share ownership; and (3) limited liability. The final section of the paper will list a number of other issues deserving statutory attention. In addition, the various issues raised by each of the professions in their reports favouring incorporation would require consideration in the drafting process.

---

123. Supra, n. 46 (reproduced in Appendix B to this working paper).

124. Supra n. 60 (reproduced in Appendix A to this working paper).

IX. ACCOUNTABILITY AND DISCIPLINE

One concern raised by permitting incorporation of professional practices is that it might lead to a reduction in the accountability of the professionals to their regulatory body. Some fear that the corporate form might create a barrier between the individual practitioner and the regulatory authority allowing him to use the corporate veil to shield himself from accountability in disciplinary proceedings. In my view,with appropriate statutory drafting any such effect can be avoided. Indeed, permitting incorporation creates the possibility of increased rather than decreased accountability of professionals.

The accountability of professionals using an incorporated practice could be achieved by requiring the professional corporation to obtain a certificate of authorization from the relevant professional regulatory body in addition to the usual licensing of the individual members of the firm. The certificate would be issued as a matter of right to corporations provided that the corporation apply to and file with the regulatory body certain prescribed information. This information might include the names and addresses of all the firm's members, the members' professional qualifications, the officers of the corporation and any other information that may be of assistance in regulating the firms. In addition, the corporation would be required to file any changes in this information as they occur and a copy of the corporation's annual report required by the corporations legislation. The regulatory authority could maintain an up to date registry of this information accessible both to the regulatory authority and the public. Furthermore, both the corporation and the individual professionals within the firm engaged in alleged misconduct should be subject to

disciplinary action by the regulatory authority and the regulatory authority should be able to penalize the firm by suspending or revoking its certificate of authorization. Finally, it may be useful to grant standing to a representative of the regulatory authority to exercise remedial rights under the corporations legislation where necessary to preserve the public interest.[124a]

The net effect of these provisions would be to heighten rather than lessen the accountability of professional firms which incorporate since they would ensure both comprehensive current information about the firms and the accountability of the firm to disciplinary actions brought by the profession's regulatory authority. The provisions are based on the requirements in section 20 of the Professional Engineers Act and the equivalent provisions in Alberta's professional corporations legislation[125] and experience under the former indicates that the provisions are effective.[126] Indeed, it may well be appropriate to extend these requirements to all professional firms, whether incorporated or not, in order to ensure equality of treatment in the provision of information and accountability to disciplinary proceedings.[126a]

124a. The recommended status would be analogous to that granted a "complainant" under section 231 of the Canada Business Corporations Act.

125. See Appendix B. They are also similar to the procedures under the Surveyors Act, R.S.O. 1970 c. 452.

126. See Appendix D to the Research Directorate's Staff Study, supra n.1, pp.210ff.

126a. The Professional Engineers Act, R.S.O. 1970, c. 366 imposes such a requirement.

X. BENEFICIAL SHARE OWNERSHIP

A common feature of professional corporations statutes is a requirement that the beneficial ownership of the issued shares of the corporation be restricted to licensed members of the profession. For example, in the recent Alberta legislation, this requirement is applied to accountants,[127] dentists,[128] lawyers,[129] and physicians.[130] Similarly, in many American jurisdictions the requirement is applied.[131] Section 9 of the Model Professional Corporations Act[132] enacts a similar requirement. In Ontario, the proposal for incorporation supported by the Institute of Chartered Accountants[133] contemplates the same requirement as did the recommendations of the Committee on the Healing Arts regarding doctors[134] and dentists.[135]

Despite this general approach, there are numerous clear exceptions. For example, there is no requirement of beneficial share ownership for engineering corporations in Ontario.[136] Somewhat differently, land surveyors who incorporate in Ontario are required to maintain beneficial ownership of a simple majority of each class of the corporation's shares.[137] Similarly,

---

127. Chartered Accountants Act, R.S.A. 1970, c.42 as amended, s.54 (3)(f).

128. Dental Association Act, R.S.A. 1970, c.90 as amended, s.70(3)(g).

129. Legal Profession Act, R.S.A. 1970, c.203 as amended, s.113(3)(f).

130. Medical Profession Act, S.A. 1975, c.26 as amended, s.87(3)(f).

131. Cavitch, supra n. 53, pp. 82-18 to 82-20.

132. Supra n. 53.

133. Report (1970), supra n. 73, p. 13.

134. Report (1970) supra n. 25, Volume 2, p. 94-95.

135. Ibid, p. 241.

136. See Appendix D to the Research Directorate's Staff Study, supra n.1, pp. 210ff.

137. Surveyors Act, R.S.O. 1970, c.452, s.26(2)(c).

pharmacists in Ontario must retain ownership of a majority of each class of shares[138] although pharmacies incorporated prior to 1954 are not subject to this requirement.[139] The draft Architects Act does not prescribe a specific beneficial ownership requirement as the question is left to be prescribed by regulation.[140] However, it is understood that while the Ontario Association of Architects initially supported a 100% requirement, a compromise position of 66 2/3% has been suggested.[141]

The position of the Law Society of Upper Canada on beneficial ownership is somewhat unclear. While the 1969 Report of the Special Committee on the Incorporation of Law Practices would have imposed a 100% requirement, the 1977 Report of the Committee held out the possibility of non-voting shares being held by members of the professional's family.[142] The motivation for this latter relaxation in the 100% requirement is the potential for increased tax savings by means of allocating shares within the professional's family.[143]

The purpose of this section of the paper is to canvas briefly the factors warranting consideration in reaching a decision on this issue and to make some tentative recommendations. Fortunately, Professor Quinn's paper has already surveyed this issue and his method of analysis is in large part adopted here.[144]

---

138. Pharmacy Act, R.S.O. 1970, s.39(2).

139. See text supra at notes 28-34 for a discussion of the background to this provision.

140. Section 15(2)(c).

141. Supra n. 65.

142. See the text supra at notes 88-95. It is interesting to note that the Alberta legislation does not permit any relaxation of the 100% requirement, even for family members.

143. McDonnell, supra n. 5, pp. 194-199.

144. Quinn, supra n. 2a, pages 65-76.

Four preliminary points should be made. First, the issue of beneficial ownership is not uniquely raised by the corporate form. Exactly the same problem is raised in the partnership context. Second, the resolution of this issue should reflect, not determine, the question of multi-disciplinary firms. As was stated earlier in this paper,[145] multi-disciplinary corporations can be accommodated by appropriate drafting of exemptions if they would otherwise be inconsistent with beneficial ownership requirements. Third, the dichotomy between equity and debt interests in a firm should not be overstated. While in theory and in form the role of the holders of equity and debt in a firm may differ substantially, in substance the differences may not be as great. The passive nature of some equity interests and the active involvement of some creditors in the operation of a firm serve to cloud the distinction between the two. Fourth, some variation is possible in the type of equity ownership involved; in particular, non-voting shares could be used as a vehicle to facilitate non-professional equity ownership while limiting non-professional participation in the firm's decision-making process.

The rationale for restrictions on beneficial ownership of shares of a professional corporation is, at its broadest, a concern about lay interference with the delivery of professional services. The concern is that a lay investor in a professional corporation may have objectives in conflict with those of the professional owners and may try to direct the firm towards his objectives to the detriment of the professional services and thus the consumers. Stated more specifically, "the traditional argument against lay ownership devolves into an assertion that lay entrepreneurs [investors] are more likely than professional owners and managers to take advantage of the opportunities for exploiting consumers which arise from the peculiar imperfections of the professional services market."[146]

---

145. See text at notes 64 to 71.

146. Quinn, supra n. 2a, p. 70.

In the absence of competing concerns, the prophylactic approach represented by a 100% professional ownership requirement would be satisfactory. However, as is developed below, there are some competing considerations which might call for some relaxation of the requirement, considerations which may vary in magnitude from profession to profession. Therefore, the policy formation task is to define the relevant trade-offs among the competing considerations.

Before proceeding with the analysis, it is useful to define three types of potential owners since each raises somewhat different rationales. First, the owner may be a pure investor not participating in the production of the firm's services but wishing to hold an equity interest in the corporation. Second, the owner may be a member of the family of a professional within the firm wishing to hold an equity interest in the firm in order to maximize the tax savings available to the professional and his family. Third, the owner may be a person collaborating in the production of the firm's services but not licensed as a member of the relevant profession. He may be a lay employee of the firm or a professional from another discipline participating in a multi-disciplinary services firm.

There are two primary non-tax rationales for permitting a relaxation of the beneficial ownership requirement. First, to deny non-professional participants in the firm the right to own shares is to relegate them to permanent employee status. While the magnitude of the disincentives thereby created are difficult to measure, it is likely that professional corporations will have some difficulty attracting and retaining skilled and senior non-professional employees. This will be of particular relevance in the multi-disciplinary services firm but will also be important in attracting managerial

services to professional firms.[147]

The second potential advantage of lay investment in a professional corporation is that it may serve as a source of equity capital at a lower cost of capital than that facing the professional members of the firm. It may well be that in a range of personal circumstances some professionals will face significant costs in financing their firms, costs which could be mitigated by permitting lay equity investment. While debt financing may be an alternative source of capital, it is not a perfect substitute and in some situations it may be substantially less attractive.

The magnitude of these two advantages varies, of course, with the class of owner and the particular profession being considered. With respect to the three types of owners defined above, the source of capital advantage is primarily related to the pure investor while the avoidance of perpetual employee status advantage applies only to those collaborating in the production of the firm's services. Neither of the advantages will be realized by permitting the family members to own shares since these advantages are exclusively of a tax nature.

With regard to the different professions, while the avoidance of perpetual employee status will be of relevance to each of the professions, it will be of greatest relevance in those with significant potential for mixed practices. The source of capital advantage is directly related to the magnitude and nature of the financial requirements of the firms in the profession.

---

147. In some situations, non-professional ownership could constitute unethical fee-splitting under present rules. If the ownership requirements were relaxed, a corresponding exemption from the fee-splitting prohibition should be enacted.

With these factors in mind, the trade-off can be identified as between potential lay interference with the provision of professional service, and the advantages of access to capital and adequate incentive schemes for non-professional collaborators in the firm. To the extent that interference is the concern, a number of other responses are possible to minimize the potential harm. Non-voting shares could be used as could restrictions on the qualifications of directors and officers of the corporation. Additionally, the disciplinary apparatus of the professional regulatory authority could be exercised if there were some perceived departure from the consumer interest. It is interesting to note that the Association of Professional Engineers of Ontario has found that disciplinary proceedings against the firms and the individual professionals within them have been sufficient controls and that there is no need for any beneficial ownership requirement. [148]

Recognizing the intangible nature of both the advantages and disadvantages of relaxing the beneficial ownership requirement, it is extremely difficult to formulate any firm conclusions. To a substantial degree the final decision must be a judgment and not an analysis. My conclusion is that the avoidance of permanent employee status may be a considerable advantage and should be accomodated in each of the professions. This could be accomplished by creating a specific exemption from the ownership requirement to meet the needs of lay participants in the production of professional services. However, the percentage ownership required for this may not be large and will always be less than total non-professional ownership.

---

148. See Appendix D to the Research Directorate's Position Paper, supra n.1, pp. 210ff.

Further, in my view, there is no need to introduce any share constraint in the engineering profession; the profession's experience has been satisfactory and there is no demonstrated need to alter the conditions.

With regard to architecture, it is essential that adequate flexibility be provided for mixed firms but beyond that it is difficult to assess where the trade-off lies. On balance, for the reasons offered by Professor Quinn, I would favour some relatively small minimum professional ownership requirement in the absence of evidence demonstrating significant advantages to the complete elimination of the requirement.

Accounting presents a similar but somewhat different case in that it is more difficult to foresee significant advantages to relaxing the share ownership requirement beyond accommodating lay participants in the firms work. At the same time the potential costs of substantial lay interference with service delivery may be greater as the likelihood of opportunities for exploiting market failure may be greater than in engineering and architecture. On the other hand, the magnitude of the potential advantages should not be understated since structual innovation facilitated by new sources of equity capital may lead to substantial efficiency gains. I would, therefore, extend beneficial ownership both to those persons collaborating in the provision of the firm's services and to lay investors offering equity capital while maintaining some relatively substantial minimum professional ownership requirement.

With respect to law it is somewhat more difficult again to foresee significant advantages to relaxing the share ownership requirements beyond accommodating lay participants in the firm's work. Of the four professions under study, law offers the most extensive opportunities for exploiting market failures and therefore it is arguable that the potential costs of lay

interference with service delivery is greatest. At the same time, the equity capital needs of the firms are relatively low. Therefore, for law, I would be hesitant in extending beneficial ownership substantially beyond those persons actually collaborating in the provision of the firm's services.

Finally, the question of ownership by other family members must be resolved on distributive and equity grounds since the only advantages are of a tax nature. The analysis is similar to that canvassed in section VII of the paper. Again, my views have no particular claim to legitimacy on this distributive question.

XI. LIMITED LIABILITY

As was explained above,[149] if a professional firm were to change from a partnership to a corporation the owners would, in the absence of statutory amendment, reduce their potential liability for the acts of the corporation and its shareholder/employees. The primary reduction arises from the fact that while in a partnership a partner is jointly liable for the acts of his fellow partners, in a corporation only the corporation itself and not its shareholders are liable for the negligent acts of its shareholder/employees. Therefore, in the corporate form, a shareholder/employee remains personally liable for his own acts of negligence but is relieved of personal liability for the acts of his fellow shareholder/employees. The question arises whether this traditional attribute of incorporation -- limited liability -- should be abrogated in the context of professional corporations.

---

149. See text supra at note 99 ff. There is a considerable literature on limited liability. See Prins, supra n. 53; Comment, "The Validity of Limited Tort Liability for Shareholders in Close Corporations", (1973) 23 American U. L. Rev 208; Comment, "Inadequate Capitalization as a Basis for Shareholder Liability: The California Approach and a Recommendation", (1972) 45 So. California L. Rev. 823; Comment, "Should Shareholders be Personally Liable for the Torts of Their Corporations", (1967) 76 Yale L.J. 1190; Landers, "A Unified Approach to Parent, Subsidiary and Affiliate Questions in Bankruptcy", 42 U. Chi. L. Rev. 589 (1975) and 43 U. Chi. L. Rev. 527 (1976); Posner, "The Rights and Creditors of Affiliated Corporations", 43 U. Chi. L. Rev 499 (1976).

That this question is not readily resolved is demonstrated by the A.B.A.'s Model Professional Corporations Act. While on most issues the model Act presents a single recommendation, on the issue of limited liability the Act reflects the diversity of state provisions and provides three alternative provisions.[150] Similarly, in Ontario, the engineers enjoy limited liability, the architects would have received it under the draft Architects Act, the lawyers do not seek it and the accountants do not appear to have taken a position regarding it.[151] In Alberta, the dentists, doctors, lawyers and accountants were not granted limited liability as part of being permitted to incorporate.[152]

The resolution of this issue for the four professions in Ontario requires a brief evaluation of the traditional rationale for limited liability and its applicability to professional corporations. It is argued that limited liability encourages entrepreneurship and risk-taking thereby increasing the aggregate level of economic activity. This stimulus to entrepreneurship is provided not by reducing the aggregate risks in transactions but rather by reducing the cost to the entrepreneur of risk-taking. This is accomplished by assigning part of the risk of transactions -- the risk of an uncompensated loss -- to the creditors, clients or injured third parties of the corporation. In a financing transaction, the risk to the creditor is that the obligation owed to the creditor will not be met by the assets of the corporation. In the purchase of services, the risk to the client is that the services will

---

150. Model Act, supra n. 53, section 11.

151. The ambiguity in the accountant's position can be seen in the text supra at note 82.

152. See, for example, Alberta's Legal Profession Act, s.115. For a review of the liability provisions respecting professional corporations for accountants, architects, dentists, doctors, engineers, land surveyors, lawyers and pharmacists in all the provinces, see Appendix D to this paper.

prove substandard or defective and that there will be insufficient corporate assets to provide adequate relief. In the case of an injured third party, the risk to the third party is that the corporate assets will not be sufficient to provide full compensation.

The mere allocation of the risk of certain losses to different parties is not itself evidence of a suboptimal situation. In any commercial transaction the risks of undesirable outcomes must be assigned and the particular allocation agreed upon or imposed may or may not be desirable. The key question is whether or not the person bearing the risk is appropriately compensated for so doing.

In financing transactions, one may assume that as a general rule the terms of the agreement will reflect the assessment and allocation of the risks involved. Furthermore, to the extent the risk assignment dicated by the rule of limited liability is unsatisfactory to the parties, they can contract away from it. For example, with a small corporation it is common for the party providing the financing to extract a personal guarantee from the principal shareholder so as to reduce the risk of an uncompensated loss by avoiding the rule of corporate limited liability. Therefore, in financing arrangements where the transactions costs of reaching a mutually satisfactory assignment of the risks are relatively low, the rule of limited liability is acceptable in that it can be rendered irrelevant if the parties so desire.

The same general analysis can be applied to the customers of a corporation since the terms of trade should reflect the assignment of risks inherent in the role of limited liability. Some caution should, however, be noted. To the extent that the transactions costs of negotiating variations in the terms of trade are high and to the extent that the customers are

unable to assess the risks of default by the corporation because of the information costs, then the rule of limited liability may create suboptimal outcomes. These will arise because although the parties are in a voluntary, transacting relationship of buyer and seller, the transactions and information costs may prevent the terms of trade from fairly reflecting the assignment of risks in the agreement.

The situation of injured third parties is quite different since in these cases the relationship between the corporation and the injured person is involuntary and established in the absence of bargaining. In these situations, it can be said with certainty that the "terms of trade" will not reflect the assignment of risks as the corporation is able to externalize some risk without compensating third parties for bearing it.

As a result, in the case of third parties and, to a lesser extent, customers, whatever increase in risk taking is induced on the part of entrepreneurs freed from unlimited liability is subsidized by uncompensated parties. Seen in this light, a rule of limited corporate liability appears difficult to justify particularly for professional firms where third parties and customers facing high transactions and information costs are prevalent.

One other dimension of limited liability needs to be introduced to complete the analysis. If the rules of liability in a corporation were the same as those in a partnership -- "unlimited liability" -- the risk of being a shareholder of a corporation would depend on the financial worth of the other shareholders since that would influence the likelihood of a corporate obligation being enforced personally against an individual shareholder. Similarly, the risk of entering a transaction with a company would vary with changes in shareholders since the assets available for meeting the corporation's obligation would change with each transfer of shares. The

net result of these two effects would be to render public capital markets ineffective or, at best, very inefficient. As a necessary result, therefore, for corporations with a relatively large number of shareholders the rule of limited liability is desirable as a means of promoting efficient capital markets.

The analysis would presumably lead to a rule of limited liability only for corporations with widely distributed shareholdings and a rule of shareholder liability analogous to partnership liability for companies with relatively few shareholders. However, the analysis is incomplete because it fails to recognize that even in a partnership, liability is of course limited; it is limited to the extent of the partners' assets. Similarly, even if professional corporations were denied limited liability, liability would still be limited by the assets of the shareholders, the value of which will vary in largely fortuitous ways from the point of view of injured third parties. Thus, the solution to the problem of uncompensated losses can be found not in rules of corporate liability (although they may help) but rather in compulsory insurance.

It is beyond the scope of this paper to investigate all aspects of compulsory insurance for professional firms. Presumably, Professor Belobaba's paper on civil liability will address this question. Although thorough study may raise other compelling dimensions to the issue, from the point of view of corporate liability and uncompensated losses there would appear to be a strong case for a significant compulsory insurance requirement for professional corporations.[152a] The magnitude of the insurance requirement should be related

---

152a. A compulsory insurance requirement is not necessarily inconsistent with the deterrent advantages of civil liability; a sophisticated scheme of mandatory deductibles could preserve the deterrent effects while at the same time ensuring that plaintiffs are compensated.

to the size of the firm as measured by either the number of professionals participating in the firm or some other proxy for the likely liability exposure of the firm.[152b] Furthermore, the statutory provision creating the requirement should also include a mechanism whereby the coverage level will automatically increase with inflation.[152c]

Before formulating recommendations, two problems remain. First, given that engineers at present enjoy limited liability, ought that to be changed and, if not, does that have implications for the liability rule for architects? Second, is there a case for distinguishing between the obligations of the firm arising from its professional services and obligations arising as a normal incident of commerce?

On the first question, the analysis above would suggest that for closely-held engineering corporations the rule of limited liability should be abrogated. However, recognizing the difficulty of instituting such a proposal for engineers at this stage, a secondary solution of substantial compulsory insurance should be adopted. The same insurance requirement should be applied to widely-held corporations as well. Given this recommendation, it might be argued that architects should be entitled to the same treatment given the substitutability of services, the historical relationship

---

152b. See, for example, Model Act, supra n. 53, section 11(d) (Alternate 3).

152c. Ideally, the required coverage should also be sensitive to changes in the substantive rules of liability governing the profession.

of the disciplines and the potential for mixed firms.[152d] The case does not seem persuasive except to the extent that a substantial number of mixed firms are expected and would be complicated by different liability rules. However, if compulsory insurance at sufficiently high levels were adopted for all architectural firms, then limited liability could be extended to architecture with little risk of losses being imposed on uncompensated parties.

Some have suggested that while professional corporations should have unlimited liability for matters arising from the delivery of professional services, this personal liability need not extend to normal commercial obligations.[153] Given the analysis above, the issue becomes relatively unimportant since the obligations will arise in the context of voluntary transactions in which the terms of trade can reflect the allocation of risks. My preference is to reject the distinction in order to avoid confusion and misunderstanding arising from misinformation effects. However, it is difficult to make a compelling argument one way or the other.

In conclusion, on the question of limited liability, I recommend that it not be extended to closely-held professional firms and that it be used only in the case of firms with such dispersed shareholdings that the uncertainties generated by share transfers would be unacceptable. The statutory provision

---

152d. A further argument for granting architects the privilege of limited liability is that fairness in the sense of horizontal equity dictates that engineers and architects be treated equally. This argument should be rejected since it draws a misleading analogy to the concept of horizontal equity in a taxing statute. The critical distinction is that the cost of achieving equity under a taxing statute is borne by the population generally in the form of reduced revenues while the cost of achieving "equity" in the context of limited liability will be borne by fortuitously selected individuals suffering uncompensated losses.

153. The Lawrence Committee recommended that this distinction be drawn. See Interim Report, supra n. 1, p. 20. It is interesting to note that the Alberta legislation does not make such a distinction.

distinguishing the closely-held and widely-held firms should be based simply on the number of shareholders in the corporation. The statute should delineate the point at which the shareholders are sufficiently numerous that a public market in the corporation's shares would be a realistic possibility and extend the privilege of limited liability to these companies. Some evidence of the absolute number of shareholders required to create a public market can be derived from the listing requirements of the stock exchanges. For example, the Vancouver Stock Exchange requires a minimum of 100 shareholders (exclusive of promoters, directors and other insiders), The Montreal Stock Exchange 200 shareholders and the Toronto Stock Exchange 300 shareholders.[153a] The case of engineers and architects may warrant separate treatment along the lines suggested above. However, under no circumstances should limited liability be permitted in the absence of compulsory insurance at levels sufficiently high to reflect the potential liabilities of the firm. In addition, the question of compulsory insurance even in situations of unlimited liability should be given serious attention.

XII. MISCELLANEOUS PROVISIONS

The paper has surveyed only the major issues in drafting a professional corporations statute. There are a host of subsidiary issues which would need to be dealt with in the drafting process: the corporation name, director and officer requirements, meeting and notice provisions, minimum capital, corporate repurchase of shares, audit requirements, shareholder agreements

---

153a. See CCH Canadian Securities Law Reporter at 94-852, 86-801 ff and 92-038 ff respectively. If there were significant constraints on the beneficial ownership of the shares, the relevant minimum number of shareholders would have to be increased.

and objects clauses. Furthermore, it is essential that the interrelationship of the professional corporations statute with other corporate and securities legislation be carefully considered. However, these issues can be resolved satisfactorily in the usual statutory drafting process since they do not go to the seminal issue of whether or not to permit incorporation. In all cases, the particular provisions should be designed to maximize the likelihood that the potential efficiencies of incorporation will be realized without detracting from the fiduciary, ethical and service responsibilities of the professionals.

XIII. CONCLUSION

This paper makes no recommendation as to whether or not professionals should be permitted to incorporate. Rather it attempts to assess the potential non-tax advantages and disadvantages of incorporation and to delineate the implications for incorporation of the absence of tax neutrality between partnerships and corporations. The Committee is left the task of assigning the relative importance of the two types of impacts and formulating a recommendation which integrates them. This integration will likely be related to the Committee's total calculus of regulatory reform and its expected impact on the professions.

Despite this ambivalence on the central recommendation, the paper does offer the firm conclusion that with appropriate statutory drafting it is possible to devise a corporate form consistent with the ethical, fiduciary and service responsibilities of the professions. Therefore, if the Committee were to favour incorporation, it could do so with confidence that it could be accomplished without prejudice to the delivery of professional services.

APPENDIX A

PROFESSIONAL CORPORATION SUPPLEMENT TO THE MODEL BUSINESS CORPORATION ACT

TABLE OF CONTENTS

CROSS REFERENCE TABLE

Model Professional Corporation Act	Related Sections of Model Business Corporation Act
Section 1	Section 1
Section 2	Section 2
Section 3	Section 3
Section 4	None
Section 5	Section 4
Section 6	None
Section 7	Section 6
Section 8	Section 8, 108
Section 9	Section 15, 20, 23, 24
Section 10	Section 81
Section 11	Section 25
Section 12	None
Section 13	Section 33, 34
Section 14	Section 35, 50
Section 15	Section 59, 61
Section 16	Section 71, 72, 77
Section 17	None
Section 18	Section 94, 95
Section 19	Section 106
Section 20	Section 110
Section 21	Section 121
Section 22	Section 125
Section 23	None
Section 24	Section 137, 138
Section 25	Section 135, 136
Section 26	None
Section 27	None
Section 28	Section 147
Section 29	Section 149
Section 30	Section 150
Section 31	Section 151
Section 32	Section 152

_____* _____ PROFESSIONAL CORPORATION ACT

SECTION 1. *SHORT TITLE*

This Act shall be known and may be cited as the "_____ Professional Corporation Act."

Comment

This model professional corporation act is designed as a supplement to the Model Business Corporation Act. Section 27 provides that the state's business corporation act shall apply to professional corporations except to the extent its provisions are inconsistent with the supplemental act. Accordingly, the supplement must be read in conjunction with the Model Business Corporation Act which it closely parallels in structure and semantics. With appropriate modifications, however, this model act may readily be adapted for use as a supplement to other business corporation acts.

SECTION 2. *DEFINITIONS*

As used in this Act, unless the context otherwise requires, the term:

(1) "Professional service" means any service which may lawfully be rendered only by persons licensed under the provisions of a licensing law of this State and may not lawfully be rendered by a corporation organized under the _____ Business Corporation Act.

(2) "Licensing authority" means the officer, board, agency, court or other authority in this State which has the power to issue a license or other legal authorization to render a professional service.

(3) "Professional corporation" or "domestic professional corporation" means a corporation for profit subject to the provisions of this Act, except a foreign professional corporation.

(4) "Foreign professional corporation" means a corporation for profit organized for the purpose of rendering professional services under a law other than the law of this State.

(5) "Qualified person" means a natural person, general partnership, or professional corporation[1] which is eligible under this Act to own shares issued by a professional corporation.

(6) "Disqualified person" means any natural person, corporation, partnership, fiduciary, trust, association, government agency, or other entity which for any reason is or becomes ineligible under this Act to own shares issued by a professional corporation.

---

* Supply name of State as required throughout the act.

1. Delete "professional corporation" if alternate 2 or 3 of Section 11 (d) is adopted.

Comment

Paragraph (1). The definition of "professional service" limits and describes the purposes for which corporations may be organized under Section 3.

As a general proposition, corporations may not be formed under business corporation acts for the purpose of practicing a profession. In the absence of any statutory definition of the word "profession," the courts have held that, although a licensing requirement is characteristic of the professions, all licensed services are not necessarily professional services which may not be rendered by corporations. Accordingly, the determination as to whether particular licensed services may be rendered by corporations has been made on a case by case basis based upon construction of the state business corporation law or the applicable licensing law.[2]

Some of the existing state statutes under which professional persons are permitted to incorporate cover all licensed services. Statutes of this type are not restricted to persons who are prohibited from incorporating under the business corporation law. Other existing state statutes limit those who may incorporate to specific professions described in a single statute or in a series of similar statutes each applicable to one profession. The definition of "professional service" in paragraph (1) has the effect of restricting the use of the act to the practice of the professions. Rather than listing designated professions, however, the model act follows the precedent set by many existing state statutes of defining professional services as those licensed services which may not be rendered by a corporation organized under the business corporation law.

Paragraph (2). See Section 26 with respect to jurisdiction of the licensing authority over professional corporations.

Paragraphs (5) and (6). See comment following Section 9.

SECTION 3. *PURPOSES*

(a) Except as hereinafter provided in this section professional corporations may be organized under this Act only for the purpose of rendering professional services and services ancillary thereto within a single profession.

(b) A professional corporation may be incorporated for the purpose of rendering professional services within two or more professions and for any purpose or purposes for which corporations may be organized under the _____ Business Corporation Act to the extent that such combination of professional purposes or of professional and business purposes is permitted by the licensing laws of this State applicable to such professions and rules or regulations thereunder.

---

2. Model Bus. Corp. Act Ann. 2d, Sec. 3, Par. 4.01.

Comment

Apparently most state legislatures have felt that it was necessary to limit the purposes of a professional corporation to the practice of a single profession, and subsection (a) follows the large majority of existing state statutes in this respect. However, the ethical proscriptions of the various professions are not uniform in restricting the activities of a professional group to a single professional field. Some professional groups such as engineers and architects are permitted to carry on joint practice, and in other fields, such as the field of medicine and allied health professions, the extent to which professional practices may be combined is an evolving subject. Accordingly, subsection (b) shifts the responsibility for determining the extent to which two or more professions may combine and the extent to which a professional corporation may engage in business activities to the licensing statutes and regulations governing each profession where variations in public policy and ethical requirements of the various professions may be properly treated.

SECTION 4. *PROHIBITED ACTIVITIES*

A professional corporation shall not engage in any profession or business other than the profession or professions and businesses permitted by its articles of incorporation, except that a professional corporation may invest its funds in real estate, mortgages, stocks, bonds or any other type of investment.

Comment

Although not normally found in a business corporation law, an express statutory prohibition against ultra vires acts is fairly common in the existing state professional corporation laws. This prohibition provides a basis on which the licensing authority may initiate enforcement action pursuant to Section 18 to prevent a professional corporation from engaging in prohibited activities.

SECTION 5. *GENERAL POWERS*

A professional corporation shall have the powers enumerated in the _____ Business Corporation Act, except that a professional corporation may be a promoter, general partner, member, associate, or manager only of a partnership, joint venture, trust or other enterprise engaged only in rendering professional services or carrying on business permitted by the articles of incorporation of the corporation.

Comment

Under existing statutes professional corporations generally have all the powers of business corporations. The model act restricts only the power to participate in partnerships and similar enterprises engaged in activities not

permitted to the professional corporation. Investment in limited partnerships as a limited partner would not be prohibited by the model act.

SECTION 6. *RENDERING PROFESSIONAL SERVICES*

A professional corporation, domestic or foreign, may render professional services in this State only through natural persons permitted to render such services in this State; but nothing in this Act shall be construed to require that any person who is employed by a professional corporation be licensed to perform services for which no license is otherwise required or to prohibit the rendering of professional services by a licensed natural person acting in his individual capacity, notwithstanding such person may be a shareholder, director, officer, employee or agent of a professional corporation, domestic or foreign.

Comment

A statement similar to the first clause of Section 6 to make it clear that unlicensed employees of professional corporations are not authorized to render professional services is included in the statutes of all states. The second clause which is also common in existing statutes is intended to insure that the use of para-professionals and other assistants customarily employed by professionals will not be inhibited by the first clause and also to recognize that a licensed employee of a professional corporation may render services in his individual capacity rather than as an employee of the corporation depending upon the circumstances of his employment. For example, an employee of a professional corporation may render professional services in his individual capacity in states in which the professional corporation may not be admitted as a foreign corporation.

SECTION 7. *RIGHT OF CORPORATION TO ACQUIRE ITS OWN SHARES*

A professional corporation may purchase its own shares from a disqualified person without regard to the availability of capital or surplus for such purchase; however, no purchase of or payment for its own shares shall be made at a time when the corporation is insolvent or when such purchase or payment would make it insolvent.

Comment

Nearly all professional corporation statutes require that shareholders be licensed professional persons, and to implement this requirement most statutes require that the corporation repurchase shares which have become the property of unlicensed persons through operation of law. The usual business corporation law restriction against impairment of capital by purchase of the corporation's own shares may conflict with this statutory requirement for the purchase of shares of a professional corporation. Section 7 of the model

act resolves the conflict by removing the Model Business Corporation Act limitation on purchase of shares to the extent of available earned surplus or capital surplus while retaining the insolvency test of Section 6 of the Model Business Corporation Act. Section 10 (a) of the professional corporation supplement requires the corporation to repurchase shares "to the extent of funds which may be legally made available for such purchase." Thus the requirement of Section 10 that the professional corporation repurchase the shares of a disqualified person will be subject to the insolvency restriction against repurchase but will not be subject to the capital and surplus restriction.

SECTION 8. *CORPORATE NAME*

The name of a domestic professional corporation or of a foreign professional corporation authorized to transact business in this State:

(1) shall contain the words "professional corporation" or the abbreviation "P.C.";

(2) shall not contain any word or phrase which indicates or implies that it is organized for any purpose other than the purposes contained in its articles of incorporation;

(3) shall not be the same as, or deceptively similar to, the name of any domestic corporation existing under the laws of this State or any foreign corporation authorized to transact business in this State, or a name the exclusive right to which is, at the time, reserved in the manner provided in the _____ Business Corporation Act, or the name of a corporation which has in effect a registration of its corporate name as provided in the _____ Business Corporation Act; except that this provision shall not apply if:

(i) such similarity results from the use in the corporate name of personal names of its shareholders or former shareholders or of natural persons who were associated with a predecessor entity; or

(ii) the applicant files with the Secretary of State either of the following: (A) the written consent of such other corporation or holder of a reserved or registered name to use the same or deceptively similar name and one or more words are added to make such name distinguishable from such other name, or (B) a certified copy of a final decree of a court of competent jurisdiction establishing the prior right of the applicant to the use of such name in this State; and

(4) shall otherwise conform to any rule promulgated by a licensing authority having jurisdiction of a professional service described in the articles of incorporation of such corporation.

Comment

Existing state statutes vary in the selection of terms required in the corporate name as corporate designators. To encourage uniformity and avoid

confusion the model act approves and requires only the term "professional corporation" or its abbreviation. The Model Business Corporation Act corporate name provision is further modified in paragraph (3) (i) to permit similarity of names if the similarity results from the use of personal names of persons associated with the organization. Paragraph (4) authorizes the licensing authority to impose by rule additional requirements appropriate to a particular profession.

SECTION 9. *ISSUANCE AND TRANSFER OF SHARES; SHARE CERTIFICATES*

(a) A professional corporation may issue shares, fractional shares, and rights or options to purchase shares only to:

(1) natural persons who are authorized by law in this State or in any other state or territory of the United States or the District of Columbia to render a professional service permitted by the articles of incorporation of the corporation;

(2) general partnerships in which all the partners are qualified persons with respect to such professional corporation and in which at least one partner is authorized by law in this State to render a professional service permitted by the articles of incorporation of the corporation; and

(3) professional corporations, domestic or foreign, authorized by law in this State to render a professional service permitted by the articles of incorporation of the corporation.[1]

(b) Where deemed necessary by the licensing authority for any profession in order to prevent violations of the ethical standards of such profession, the licensing authority may by rule further restrict, condition, or abridge the authority of professional corporations to issue shares but no such rule shall, of itself, have the effect of causing a shareholder of a professional corporation at the time such rule becomes effective to become a disqualified person. All shares issued in violation of this section or any rule hereunder shall be void.

(c) A shareholder of a professional corporation may transfer or pledge shares, fractional shares, and rights or options to purchase shares of the corporation only to natural persons, general partnerships and professional corporations[2] qualified hereunder to hold shares issued directly to them by such professional corporation. Any transfer of shares in violation of this provision

---

1. Delete paragraph (3) of subsection (a) if alternate 2 or 3 of Section 11 (d) is adopted.
2. Delete "professional corporations" if alternate 2 or 3 of Section 11 (d) is adopted.

shall be void; however, nothing herein contained shall prohibit the transfer of shares of a professional corporation by operation of law or court decree.

(d) Every certificate representing shares of a professional corporation shall state conspicuously upon its face that the shares represented thereby are subject to restrictions on transfer imposed by this Act and are subject to such further restrictions on transfer as may be imposed by the licensing authority from time to time pursuant to this Act.

Comment

The model act departs from existing state statutes in permitting shares of a professional corporation to be issued to persons licensed outside the state of incorporation and to partnerships and other professional corporations authorized to render a professional service permitted by the articles of incorporation of the corporation.

Pennsylvania also permits a professional corporation to issue shares to persons licensed in another state, but existing statutes generally restrict shareholders to natural persons. If shareholders are not liable for debts of the corporation, however, there is no policy reason to prohibit the issuance of shares to another corporation which is subject to the same professional corporation requirements, and under Section 9 of the model act professional corporations may be given the same flexibility in planning the corporate structure as business corporations. If shareholders are personally liable for the performance of professional services rendered on behalf of the corporation, however, as they may be under either alternate 2 or 3 of Section 11 (d), then the holding company device may be used to avoid personal liability, and accordingly, paragraph (3) of subsection (a) should be deleted if alternate 2 or 3 of Section 11 (d) is adopted.

Section 9 of the model act is applicable to all classes of shares issued by a professional corporation. No qualifications are imposed by the model act (or by existing state statutes) on holders of debt securities. It is unlikely that convertible debt will be issued by a professional corporation, since the corporation will not have the power to issue its shares upon conversion if the holder is not a qualified person at the time the shares are to be issued.

SECTION 10. *DEATH OR DISQUALIFICATION OF A SHAREHOLDER*

(a) Upon the death of a shareholder of a professional corporation or if a shareholder of a professional corporation becomes a disqualified person or if shares of a professional corporation are transferred by operation of law or court decree to a disqualified person, the shares of such deceased shareholder or of such disqualified person may be transferred to a qualified person and, if not so transferred, shall be purchased or redeemed by the corporation to the extent of funds which may be legally made available for such purchase.

(b) If the price for such shares is not fixed by the articles of incorporation or by-laws of the corporation or by private agreement, the corporation, within six months after such death or thirty days after such disqualification or transfer, as the case may be, shall make a written offer to pay for such shares at a specified price deemed by such corporation to be the fair value thereof as of the date of such death, disqualification or transfer. Such offer shall be given to the executor or administrator of the estate of a deceased shareholder or to the disqualified shareholder or transferee and shall be accompanied by a balance sheet of the corporation, as of the latest available date and not more than twelve months prior to the making of such offer, and a profit and loss statement of such corporation for the twelve months' period ended on the date of such balance sheet.

(c) If within thirty days after the date of such written offer from the corporation the fair value of such shares is agreed upon between such disqualified person and the corporation, payment therefor shall be made within sixty days, or such other period as the parties may fix by agreement, after the date of such offer, upon surrender of the certificate or certificates representing such shares. Upon payment of the agreed value the disqualified persons shall cease to have any interest in such shares.

(d) If within such period of thirty days the disqualified person and the corporation do not so agree, then the corporation, within thirty days after receipt of written demand from the disqualified person given within sixty days after the date of the corporation's written offer shall, or at its election at any time within such period of sixty days may, file a petition in any court of competent jurisdiction in the county in this State where the registered office of the corporation is located requesting that the fair value of such shares be found and determined. If the corporation shall fail to institute the proceeding as herein provided, the disqualified person may do so within sixty days after delivery of such written demand to the corporation. The disqualified person, wherever residing, shall be made a party to the proceeding as an action against his shares quasi in rem. A copy of the petition shall be served on the disqualified person, if a resident of this State, and shall be served by registered or certified mail on the disqualified person, if a nonresident. Service on non-residents shall also be made by publication as provided by law. The jurisdiction of the court shall be plenary and exclusive. The disqualified person shall be entitled to judgment against the corporation for the amount of the fair value of his shares as of the date of death, disqualification or transfer upon surrender to the corporation of the certificate or certificates representing such shares. The court may, as its discretion, order that the judgment be paid in such installments as the court may determine. The court may, if it so elects, appoint one or more persons as appraisers to receive evidence and recommend a decision on the question of fair value. The appraisers shall have such power and authority as shall be specified in the order of their appointment or an amendment thereof.

(e) The judgment shall include an allowance for interest at such rate as the court may find to be fair and equitable in all the circumstances, from the date of death, disqualification or transfer.

(f) The costs and expenses of any such proceeding shall be determined by the court and shall be assessed against the corporation, but all or any part of such costs and expenses may be apportioned and assessed as the court may deem equitable against the disqualified person if the court shall find that the action of such disqualified person in failing to accept such offer was arbitrary or vexatious or not in good faith. Such expenses shall include reasonable compensation for and reasonable expenses of the appraisers, but shall exclude the fees and expenses of counsel for and experts employed by any party; but if the fair value of the shares as determined materially exceeds the amount which the corporation offered to pay therefor, or if no offer was made, the court in its discretion may award to the disqualified person such sum as the court may determine to be reasonable compensation to any expert or experts employed by the disqualified person in the proceeding.

(g) If a purchase, redemption, or transfer of the shares of a deceased or disqualified shareholder or of a transferee who is a disqualified person is not completed within ten months after the death of the deceased shareholder or five months after the disqualification or transfer, as the case may be, the corporation shall forthwith cancel the shares on its books and the disqualified person shall have no further interest as a shareholder in the corporation other than his right to payment for such shares under this section.

(h) Shares acquired by a corporation pursuant to payment of the agreed value therefor or to payment of the judgment entered therefor, as in this section provided, may be held and disposed of by such corporation as in the case of other treasury shares.

(i) This section shall not be deemed to require the purchase of shares of a disqualified person where the period of such disqualification is for less than five months from the date of disqualification or transfer.

(j) Any provision regarding purchase, redemption or transfer of shares of a professional corporation contained in the articles of incorporation, by-laws or any private agreement shall be specifically enforceable in the courts of this State.

(k) Nothing herein contained shall prevent or relieve a professional corporation from paying pension benefits or other deferred compensation for services rendered to or on behalf of a former shareholder as otherwise permitted by law.

Comment

Existing state statutes generally require that the shares of a deceased or disqualified shareholder be transferred to a qualified shareholder or purchased by the corporation within a specified period of time following the

shareholder's death or disqualification. The model act requires payment of fair value for such shares if the corporation does not establish an alternative method, and the procedure for determining fair value set forth in subsections (b) through (f) parallels the procedure set forth in Section 81 of the Model Business Corporation Act with respect to the determination of rights of dissenting shareholders. Shares of a deceased or disqualified shareholder that have not been transferred or purchased within the time limits specified in subsection (g) are cancelled, and the shareholder's interest becomes a creditor's claim under this section.

One of the troublesome aspects of the requirement that a shareholder of a professional corporation be licensed to practice the profession is the disposition of the corporation entity of a deceased sole practitioner. Under Section 33 of the Model Business Corporation Act the executor of the estate of a sole practitioner may vote the decedent's shares in his professional corporation. See comment following Section 13. Accordingly, if the shares of a deceased shareholder are not transferred, the executor may vote the shares to dissolve the corporation or to amend the articles of incorporation to change its purposes to those of a business corporation. If the executor elects to dissolve, a licensed member of the profession must act as director and president during the winding up of the corporation's affairs. If the executor elects to amend the articles, he may do so himself by signing and filing articles of amendment pursuant to Section 15.

See comment following Section 7 concerning the effect of statutory restrictions against purchases by a corporation of its own shares resulting in impairment of capital or insolvency. To further reduce the possibility of conflict between the insolvency restriction of Section 7 and the requirement for purchase of shares under Section 10 in the event of a judicial determination of fair value, the court is expressly authorized in subsection (d) to order that the judgment be paid in installments.

SECTION 11. *RESPONSIBILITY FOR PROFESSIONAL SERVICES*

(a) Any reference to a corporation in this section shall include both domestic and foreign corporations.

(b) Every individual who renders professional services as an employee of a professional corporation shall be liable for any negligent or wrongful act or omission in which he personally participates to the same extent as if he rendered such services as a sole practitioner. An employee of a professional corporation shall not be liable for the conduct of other employees unless he is at fault in appointing, supervising, or cooperating with them.

(c) Every corporation whose employees perform professional services within the scope of their employment or of their apparent authority to act for the corporation shall be liable to the same extent as its employees.

(d) (Alternate 1) Except as otherwise provided by statute, the personal liability of a shareholder of a professional corporation shall be no greater in

any respect than that of a shareholder of a corporation organized under the _____ Business Corporation Act.

(d) (Alternate 2) Except as otherwise provided by statute, if any corporation is liable under the provisions of subsection (c) of this section, every shareholder of the corporation shall be liable to the same extent as though he were a partner in a partnership and the services giving rise to liability had been rendered on behalf of the partnership.

(d) (Alternate 3) (1) Except as otherwise provided by statute, if any corporation is liable under the provisions of subsection (c) of this section, every shareholder of that corporation shall be liable to the same extent as though he were a partner in a partnership and the services giving rise to liability had been rendered on behalf of the partnership, unless the corporation has provided security for professional responsibility as provided in paragraph (2) of this subsection and the liability is satisfied to the extent contemplated by the insurance or bond which effectuates the security.

(2) A professional corporation, domestic or foreign, may provide security for professional responsibility by procuring insurance or a surety bond issued by an insurance company, or a combination thereof, as the corporation may elect. The minimum amount of security and requirements as to the form and coverage provided by the insurance policy or surety bond may be established for each profession by the licensing authority for the profession, and the minimum amount may be set to vary with the number of shareholders, the type of practice, or other variables deemed appropriate by the licensing authority. If no effective determination by the licensing authority is in effect, the minimum amount of professional responsibility security for the professional corporation shall be the product of _____*_____ dollars multiplied by the number of shareholders of the professional corporation.

Comment

Although all existing state statutes include some provision concerning professional liability or professional responsibility, most statutes are silent as to the vicarious liability of shareholders leaving this question to be determined by the business corporation law. Several statutes clearly provide that shareholder liability is limited as in a business corporation. A few expressly state that shareholders shall be jointly and severally liable for debts of the corporation. And a few, either by statute or rule of practice, condition limited liability for some professions on maintenance of professional liability insurance. A majority of the statutes contain simply a provision to the effect that the statute does not modify any law applicable to the relationship between a person furnishing professional services and a person receiving such services including liability arising out of such professional services. Although one commentator has suggested that this statutory provision pre-

* A minimum amount to be determined by the state legislature.

serves the mutual agency and unlimited liability of partnerships,[1] Federal district courts in Ohio and Florida have held, in the context of cases involving the status of a professional corporation for Federal income tax purposes, that shareholders have limited liability under statutes of this type.[2] Accordingly, it seems that shareholders of professional corporations have limited liability under existing statutes in most states.

Section 11 of the model act states affirmatively the rules for liability of the professional corporation, its employees, and its shareholders resulting from negligence in the performance of professional services. Consistent with the common law doctrine of respondeat superior, subsection (b) limits liability of a professional employee to his personal negligence, and subsection (c) imposes liability on the corporation for conduct of professional employees within the scope of their employment or of their apparent authority.

Three alternative provisions as to liability of shareholders are proposed in subsection (d): limited liability as in a business corporation, vicarious personal liability as in a partnership, and personal liability limited in amount conditioned upon financial responsibility in the form of insurance or a surety bond. Alternate 3 would permit the licensing authority for each profession to establish the minimum amount of security required as a condition for limiting liability of shareholders and to impose requirements as to the coverage provided by the policy or bond representing the security. The minimum amount of security designated in alternate 3 would apply to any profession only if no minimum has been fixed by the licensing authority for the profession, but no attempt is made in the model act to specify minimum coverage requirements. Each alternate recognizes by the introductory phrase, "Except as otherwise provided by statute," that more specific rules as to shareholder liability may be enacted with respect to a particular profession or professions, but the formulation of statutory requirements as to either the minimum amount of security or coverage for particular professions is beyond the scope of this model act.

Limited liability of shareholders has historically been considered by the courts and by the Internal Revenue Service as one of several characteristics that distinguish the corporation from the partnership. It should be noted, therefore, that the choice of alternates in subsection (d) may affect the tax status of professional corporations formed pursuant to the act.

SECTION 12. *PROFESSIONAL RELATIONSHIPS; PRIVILEGED COMMUNICATIONS*

(a) The relationship between an individual performing professional serv-

1. Bittker, *Professional Associations and Federal Income Taxation: Some Comments and Questions*, 17 Tax Law Review 1.

2. O'Neill v. United States, 281 F. Supp. 359; Kurzner v. United States, 286 F. Supp. 839.

ices as employee of a professional corporation, domestic or foreign, and a client or patient shall be the same as if the individual performed such services as a sole practitioner.

(b) The relationship between a professional corporation, domestic or foreign, performing professional services and the client or patient shall be the same as between the client or patient and the individual performing the services.

(c) Any privilege applicable to communications between a person rendering professional services and the person receiving such services recognized under the laws of this State, whether statutory or deriving from common law, shall remain inviolate and shall extend to a professional corporation, domestic or foreign, and its employees in all cases in which it shall be applicable to communications between a natural person rendering professional services on behalf of the corporation and the person receiving such services.

Comment

Many existing state statutes contain provisions similar to Section 12 which makes it clear that any relationship of confidence that exists between a professional person and his client or patient is preserved and extends to the professional corporation and also that any privilege applicable to communications with a professional person is preserved and extends to the professional corporation.

SECTION 13. *VOTING OF SHARES*

No proxy for shares of a professional corporation shall be valid unless it shall be given to a qualified person. A voting trust with respect to shares of a professional corporation shall not be valid [unless all the trustees and beneficiaries thereof are qualified persons, except that a voting trust may be validly continued for a period of ten months after the death of a deceased beneficiary or for a period of five months after a beneficiary has become a disqualified person].[1]

Comment

Section 13 of the model act requires that the holder of a proxy and the parties to a voting trust agreement be qualified to own shares in the corporation. If shareholders may be personally liable for the performance of professional services rendered on behalf of the corporation, voting trusts should be prohibited to prevent their use to avoid personal liability. See comment following Section 9. With regard to other types of agreements regarding voting of shares, Section 34 of the Model Business Corporation Act providing that agreements among shareholders regarding voting shall be valid

1. Delete the bracketed clause if alternate 2 or 3 of Section 11 (d) is adopted.

and enforceable is unchanged by the professional corporation supplement.

Pursuant to Section 33 of the Model Business Corporation Act the shares of a professional corporation held by an administrator, executor, guardian or conservator may be voted without a transfer of such shares, and shares held by a receiver may be voted by the receiver without transfer if such authority is contained in the order of a court by which the receiver was appointed. Upon the death or insolvency of a major shareholder, it may be necessary to dissolve the corporation or amend its articles by changing its purposes to those of a business corporation. The interest of the shareholder's estate will be protected by permitting the holder of his shares to vote on such proposals. In view of the requirement of Section 14 that one-half the directors and the principal officers of a corporation be qualified shareholders, there is no significant risk that an unqualified person may exercise control over the professional practice of the corporation during the period that shares of the corporation may be owned by the estate or receiver of a shareholder under Section 10. Accordingly, the model act does not modify the provisions of the Model Business Corporation Act regarding voting by administrators and receivers.

SECTION 14. *DIRECTORS AND OFFICERS*

Not less than one-half the directors of a professional corporation and all the officers other than the secretary and the treasurer shall be qualified persons with respect to the corporation.

Comment

Section 14 requires that not less than one-half the directors and the officers other than the secretary and treasurer of a professional corporation be licensed professionals. The professional corporation statute of many states require that all directors be licensed while others require less than all. Most existing statutes also prohibit unlicensed persons from serving as officers with variations as to whether all or only certain designated offices are subject to the requirement.

SECTION 15. *AMENDMENTS TO ARTICLES OF INCORPORATION*

An administrator, executor, guardian, conservator, or receiver of the estate of a shareholder of a professional corporation who holds all of the outstanding shares of the corporation may amend the articles of incorporation by signing a written consent to such amendment. Articles of amendment so adopted shall be executed in duplicate by the corporation by such administrator, executor, guardian, conservator, or receiver and by the secretary or assistant secretary of the corporation, and verified by one of the persons signing such articles, and shall set forth:

(1) the name of the corporation;

(2) the amendments so adopted;

(3) the date of adoption of the amendment by the administrator, executor, guardian, conservator, or receiver;

(4) the number of shares outstanding; and

(5) the number of shares held by the administrator, executor, guardian, conservator, or receiver.

Comment

Section 15 enables the professional corporation of the sole practitioner to continue in existence following the death of its shareholder and simplifies the procedure for amendment of articles set forth in the Model Business Corporation Act. Without some modification of the Model Business Corporation Act procedure, the executor of the deceased shareholder's estate would be required to find another member of the profession to serve as director and president for the purpose of adopting and filing articles of amendment.

SECTION 16. *MERGER AND CONSOLIDATION*

(a) A professional corporation may merge or consolidate with another corporation, domestic or foreign, only if every shareholder of each corporation is qualified to be a shareholder of the surviving or new corporation.

(b) Upon the merger or consolidation of a professional corporation, if the surviving or new corporation, as the case may be, is to render professional services in this state, it shall comply with the provisions of this Act.

Comment

Section 16 permits mergers and consolidations among professional corporations and business corporations to the extent that professional and business purposes may be combined under Section 3. Many existing professional corporation statutes limit mergers and consolidations to domestic professional corporations incorporated for the purpose of rendering the same professional service. Such a limitation would be inconsistent with Section 3 of this Act permitting a broader statement of purposes and Section 19 providing for admission of foreign professional corporations.

SECTION 17. *TERMINATION OF PROFESSIONAL ACTIVITIES*

If a professional corporation shall cease to render professional services, it shall amend its articles of incorporation to delete from its stated purposes the rendering of professional services and to conform to the requirements of the _____ Business Corporation Act regarding its corporate name. The corporation may then continue in existence as a corpo-

ration under the_____ Business Corporation Act and shall no longer be subject to the provisions of this Act.

Comment

Section 17 resolves any question as to the power of a professional corporation to continue in existence under the business corporation act after it has ceased to render professional services and avoids the forced dissolution of a corporation whose shareholders have died or become disqualified. See comment following Section 10. A corporation which has ceased to render professional services and does not dissolve is required to amend its articles to comply with the business corporation law.

SECTION 18. *INVOLUNTARY DISSOLUTION*

A professional corporation may be dissolved involuntarily by a decree of the _____ Court in an action filed by the Attorney General when it is established that the corporation has failed to comply with any provision of this Act applicable to it within sixty days after receipt of written notice of noncompliance. Each licensing authority in this State and the Secretary of State shall certify to the Attorney General, from time to time, the names of all corporations which have given cause for dissolution as provided in this Act, together with the facts pertinent thereto. Whenever the Secretary of State or any licensing authority shall certify the name of a corporation to the Attorney General as having given any cause for dissolution, the Secretary of State or such licensing authority, as the case may be, shall concurrently mail to the corporation at its registered office a notice that such certification has been made. Upon the receipt of such certification, the Attorney General shall file an action in the name of the State against such corporation for its dissolution.

Comment

The Attorney General is authorized to enforce the requirements of the professional corporation act by bringing an action for involuntary dissolution on the grounds of failure of the corporation to comply with any provision of the act. Either the licensing authority or the Secretary of State may initiate such proceedings by certifying the grounds for dissolution to the Attorney General. See Section 24.

SECTION 19. *ADMISSION OF FOREIGN PROFESSIONAL CORPORATIONS*

(a) A foreign professional corporation shall be entitled to procure a certificate of authority to transact business in this State only if:

(1) the name of the corporation meets the requirements of this Act;

(2) the corporation is organized only for purposes for which a

professional corporation organized under this Act may be organized; and

(3) all the shareholders, not less than one-half the directors, and all the officers other than the secretary and treasurer of the corporation are qualified persons with respect to the corporation.

(b) No foreign professional corporation shall be required to obtain a certificate of authority to transact business in this State unless it shall maintain an office in this State for the conduct of business or professional practice.

Comment

Many small as well as large professional practices are conducted in more than one state by individuals licensed to practice in more than one state or by partnerships whose members are licensed to practice in various states. A serious defect in many existing state statutes is the absence of any provision concerning foreign professional corporations, although several statutes do specifically provide for admission of foreign professional corporations.

Under the foreign corporation provisions of state business corporation laws, foreign corporations are generally admitted with few if any restrictions other than restrictions as to the use of corporate names. In order to prevent a professional corporation from avoiding the professional corporation laws of the state in which it carries on its practice by incorporating in a state with more lenient professional corporation requirements, Section 19 requires that foreign corporations comply with the domestic state law requirements concerning corporate purposes and qualification of shareholders, directors and officers. Under Section 6 a foreign corporation may render professional services only through persons permitted to render such services in the state. Section 11 concerning responsibility for professional services and security for professional responsibility is applicable to foreign corporations as well as domestic corporations; and foreign corporations are subject to regulation by the licensing authority to the same extent as domestic corporations under Section 26.

Section 19(b) requires that a professional corporation obtain a certificate of authority only if the corporation maintains an office in the state. This provision would permit foreign professional corporations greater freedom in rendering professional services in the state without complying with foreign corporation law requirements than is permitted in the case of business corporations.

SECTION 20. *APPLICATION FOR CERTIFICATE OF AUTHORITY*

The application of a foreign professional corporation for a certificate of authority for the purpose of rendering professional services shall include a

statement that all the shareholders, not less than one-half the directors, and all the officers other than the secretary and treasurer are licensed in one or more states or territories of the United States or the District of Columbia to render a professional service described in the statement of purposes of the corporation.

Comment

The requirements of the Model Business Corporation Act regarding the application by a foreign corporation for a certificate of authority are modified to be consistent with the additional requirements for admission under Section 19.

SECTION 21. *REVOCATION OF CERTIFICATE OF AUTHORITY*

The certificate of authority of a foreign professional corporation may be revoked by the Secretary of State if the corporation fails to comply with any provision of this Act applicable to it. Each licensing authority in this State shall certify to the Secretary of State, from time to time, the names of all foreign professional corporations which have given cause for revocation as provided in this Act, together with the facts pertinent thereto. Whenever a licensing authority shall certify the name of a corporation to the Secretary of State as having given cause for dissolution, the licensing authority shall concurrently mail to the corporation at its registered office in this State a notice that such certification has been made. No certificate of authority of a foreign professional corporation shall be revoked by the Secretary of State unless he shall have given the corporation not less than sixty days' notice thereof and the corporation shall fail prior to revocation to correct such noncompliance.

Comment

The Model Business Corporation Act procedures for revocation of the certificate of authority of a foreign professional corporation are modified to permit the Secretary of State to revoke the certificate of authority of a foreign corporation for failure to comply with applicable requirements of the professional corporation act and to authorize the licensing authority to certify to the Secretary of State grounds for revocation of the certificate of authority of a foreign professional corporation.

SECTION 22. *ANNUAL REPORT OF DOMESTIC AND FOREIGN PROFESSIONAL CORPORATIONS*

(a) The annual report of each domestic professional corporation, and each foreign professional corporation authorized to transact business in this State, filed with the Secretary of State pursuant to the _____ Business Corporation Act shall include a statement that all the shareholders,

not less than one-half the directors, and all the officers other than the secretary and treasurer of the corporation are qualified persons with respect to the corporation.

(b) Financial information contained in the annual report of a professional corporation, other than the amount of stated capital of the corporation, shall not be open to public inspection nor shall the licensing authority disclose any facts or information obtained therefrom except insofar as its official duty may require the same to be made public or in the event such information is required for evidence in any criminal proceedings or in any other action by this State.

Comment

The Model Business Corporation Act requirements for filing an annual report with the Secretary of State are modified to include a statement showing compliance with the requirement of Section 19 as to qualification of shareholders, directors and officers and to provide that financial information shall be confidential.

SECTION 23. *ANNUAL STATEMENT OF QUALIFICATION OF DOMESTIC AND FOREIGN PROFESSIONAL CORPORATIONS*

(a) Each domestic professional corporation, and each foreign professional corporation, authorized to transact business in this State, shall file annually before March 1 with each licensing authority having jurisdiction over a professional service of a type described in its articles of incorporation a statement of qualification setting forth the names and respective addresses of the directors and officers of the corporation and such additional information as the licensing authority may by rule prescribe as appropriate in determining whether such corporation is complying with the provisions of this Act and rules promulgated hereunder.

(b) The licensing authority shall charge and collect a fee of _____ dollars for filing a statement of qualification pursuant to this Act.

Comment

Many existing professional corporation statutes require the filing of an annual report with the Secretary of State or licensing authority setting forth the names and addresses of all shareholders of the corporation. The model act requires that a professional corporation file an annual statement with the licensing authority setting forth the names and addresses of directors and officers and authorizes the licensing authority to require additional information which might include names and addresses of shareholders.

SECTION 24. *INTERROGATORIES BY LICENSING AUTHORITY*

(a) Each licensing authority of this State may propound to any professional corporation, domestic or foreign, organized to practice a pro-

fession within the jurisdiction of such licensing authority, and to any officer or director thereof, such interrogatories as may be reasonably necessary and proper to enable the licensing authority to ascertain whether such corporation has complied with all the provisions of this Act applicable to such corporation. Such interrogatories shall be answered within thirty days after the mailing thereof, or within such additional time as shall be fixed by the licensing authority, and the answers thereto shall be full and complete and shall be made in writing and under oath. If such interrogatories be directed to an individual they shall be answered by him, and if directed to a corporation they shall be answered by the president, vice president, secretary or assistant secretary thereof. The licensing authority shall certify to the Attorney General, for such action as the Attorney General may deem appropriate, all interrogatories and answers thereto which disclose a violation of any of the provisions of this Act.

(b) Interrogatories propounded by a licensing authority and the answers thereto shall not be open to public inspection nor shall the licensing authority disclose any facts or information obtained therefrom except insofar as its official duty may require the same to be made public or in the event such interrogatories or the answers thereto are required for evidence in any criminal proceedings or in any other action by this State.

Comment

Section 24 establishes a procedure for enforcement by the licensing authority similar to the procedure set forth in Section 137 of the Model Business Corporation Act for enforcement by the Secretary of State but provides that the answers to interrogatories propounded by a licensing authority shall be confidential. See comment following Section 18.

SECTION 25. *PENALTIES*

(a) Each professional corporation, domestic or foreign, that fails or refuses to answer truthfully within the time prescribed by this Act interrogatories propounded in accordance with the provisions of this Act by the licensing authority having jurisdiction of a type of professional service described in the articles of incorporation of such corporation, shall be deemed to be guilty of a misdemeanor and upon conviction thereof may be fined in any amount not exceeding five hundred dollars.

(b) Each officer and director of a professional corporation, domestic or foreign, who fails or refuses within the time prescribed by this Act to answer truthfully and fully interrogatories propounded to him in accordance with the provisions of this Act by the licensing authority having jurisdiction of a type of professional service described in the articles of incorporation of such corporation, or who signs any articles, statement, report, application or other document filed with such licensing authority which is known to such officer or director to be false in any material respect, shall be

deemed to be guilty of a misdemeanor, and upon conviction thereof may be fined in any amount not exceeding _____ dollars.

Comment

Section 25 imposes penalties for failure to answer interrogatories propounded by the licensing authority which are the same as the penalties imposed by Sections 135 and 136 of the Model Business Corporation Act for failure to answer interrogatories propounded by the Secretary of State.

SECTION 26. *REGULATION OF PROFESSIONAL CORPORATIONS*

No professional corporation, domestic or foreign, shall begin to render professional services in this State until it has filed a copy of its articles of incorporation with each licensing authority having jurisdiction of a type of professional service described in its articles of incorporation. Each licensing authority in this State is hereby authorized to promulgate rules in accordance with the provisions of this Act which specifically provide for the issuance of rules to the extent consistent with the public interest or required by the public health or welfare or by generally recognized standards of professional conduct. Nothing in this Act shall restrict or limit in any manner the authority or duty of a licensing authority with respect to natural persons rendering a professional service within the jurisdiction of the licensing authority, or any law, rule or regulation pertaining to standards of professional conduct.

Comment

Section 26 requires that a professional corporation register with the appropriate licensing authority by filing a copy of its articles of incorporation with the licensing authority and authorizes the licensing authority to promulgate rules pursuant to the act. Similar provisions appear in a number of existing statutes, and the further statement reaffirming the authority of the licensing authority with respect to licensed professionals is common to many statutes.

SECTION 27. *APPLICATION OF BUSINESS CORPORATION ACT*

The provisions of the _____ Business Corporation Act shall apply to professional corporations, domestic and foreign, except to the extent such provisions are inconsistent with the provisions of this Act.

Comment

See comment following Section 1.

SECTION 28. *APPLICATION TO EXISTING CORPORATIONS*

(a) The provisions of this Act shall apply to all existing corporations organized under any general act of this State which is repealed by this

Act. Every such existing corporation which shall be required to amend its corporate name or purposes to comply with this Act shall deliver duly executed duplicate originals of articles of amendment or restated articles of incorporation containing such amendments to the Secretary of State within ninety days after the effective date of this Act.

(b) Any corporation organized under any act of this State which is not repealed hereby may become subject to the provisions of this Act by delivering to the Secretary of State duly executed duplicate originals of articles of amendment or restated articles of incorporation stating that the corporation elects to become subject to this Act and containing such amendment of its corporate name or purposes as may be required to comply with this Act.

(c) The provisions of this Act shall not apply to any corporation now in existence or hereafter organized under any act of this State which is not repealed hereby unless such corporation voluntarily becomes subject to this Act as herein provided, and nothing contained in this Act shall alter or affect any existing or future right or privilege permitting or not prohibiting performance of professional services through the use of any other form of business organization.

Comment

While most states have adopted a single general professional corporation law applicable to all covered professions, several states have adopted a series of professional corporation laws applicable to individual professions. Section 28 of the model act sets forth procedures with respect to existing corporations which include mandatory provisions applicable to corporations incorporated under a repealed act and also provisions for voluntary compliance with this act by corporations organized under acts which may not be repealed.

SECTION 29. *RESERVATION OF POWER*

The _____*_____ shall at all times have power to prescribe such regulations, provisions and limitations as it may deem advisable, which regulations, provisions and limitations shall be binding upon any and all corporations subject to the provisions of this Act, and the _____*_____ shall have power to amend, repeal or modify this Act at pleasure.

Comment

See Model Business Corporation Act Section 149.

SECTION 30. *EFFECT OF REPEAL OF PRIOR ACTS*

The repeal of a prior act by this Act shall not affect any right accrued

* Insert name of legislative body.

or established, or any liability or penalty incurred, under the provisions of such act, prior to the repeal thereof.

Comment

See Model Business Corporation Act Section 150.

SECTION 31. *EFFECT OF INVALIDITY OF PART OF THIS ACT*

If a court of competent jurisdiction shall adjudge to be invalid or unconstitutional any clause, sentence, paragraph, section or part of this Act, such judgment or decree shall not affect, impair, invalidate or nullify the remainder of this Act, but the effect thereof shall be confined to the clause, sentence, paragraph, section or part of this Act so adjudged to be invalid or unconstitutional.

Comment

See Model Business Corporation Act Section 151.

SECTION 32. *REPEAL OF PRIOR ACTS*

(Insert appropriate provisions)

* * * *

Blue Sky Law Exemption

In most states the interest of a partner in a professional partnership is exempted by definition or otherwise from the application of the state securities law. A few states have exempted shares of a professional corporation, but many states have ignored this problem in enacting professional corporation laws. Because the "one subject" requirement of state constitutions may prohibit amendment of the state securities law in a professional corporation act, the model act does not create a securities law exemption for shares of professional corporations. It is recommended, however, that shares of professional corporations be exempted from the state securities law by appropriate amendment of that law.

Comment on the foregoing proposed Professional Corporation Supplement and Comments is invited and should be forwarded prior to March 15, 1977 to John P. Austin, 2700 Crocker Plaza, San Francisco, California 94104.

John P. Austin, Chairman
Committee on Corporate Laws

August 16, 1976
San Francisco, California

APPENDIX B

Bill 68

1975

(Second Session)

CHAPTER 44

THE ATTORNEY GENERAL STATUTES AMENDMENT ACT, 1975 (NO. 2)

(Assented to December 15, 1975)

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Alberta, enacts as follows:

The Chartered Accountants Act

R.S.A. 1970, c. 42

1. (1) The Chartered Accountants Act is amended by this section.

Amends s. 2

(2) Section 2 is amended by adding after clause (d) the following clauses:

(d1) "permit" means a permit issued pursuant to section 53, subsection (3);

(d2) "professional corporation" means the holder of a subsisting permit;

Enacts ss. 52 to 64

(3) The following sections are added after section 51:

Professional Corporations

By-laws and rules of Council

52. (1) The Council may by by-law approved by the Lieutenant Governor in Council

(a) prescribe the manner of proof as to matters required to be proven by applicants for permits;

(b) fix the fees payable to the Institute for the issuance of permits and the fees payable annually by professional corporations;

(c) provide for the creation and maintenance of a register of professional corporations and require the filing of periodic returns by such corporations;

(d) provide for the annual renewal of permits and prescribing the terms and conditions upon which renewals may be granted;

(e) prescribe the types of names by which

(i) a professional corporation, or

(ii) a partnership of two or more professional corporations, or

(iii) a partnership of one or more professional corporations and one or more individual chartered accountants,

may be known.

(2) The Council may make rules

(a) providing that the permit of a professional corporation is suspended without notice or investigation upon contravention of any by-law that requires the corporation to pay a fee or assessment, file a document or do any other act by a specified or ascertainable date, and providing for the reinstatement of a permit so suspended;

(b) providing for the reinstatement or re-issuance of any permit suspended or revoked pursuant to a by-law or order of the Council and prescribing the terms and conditions upon which reinstatement or re-issuance of a permit may be granted.

Permits

53. (1) Notwithstanding any other provision of this Act, a corporation to which a permit is issued under this section may practice or act as a chartered accountant in its own name.

(2) Notwithstanding subsection (1), no corporation shall be enrolled as a member of the Institute.

(3) The secretary shall issue a permit to any corporation which fulfils the following conditions:

(a) files an application in the form prescribed by the by-laws;

(b) pays all the fees prescribed by the by-laws;

(c) satisfies the secretary that it is a company limited by shares that is in good standing with the Registrar of Companies under *The Companies Act;*

(d) satisfies the secretary that the objects of the company stated in its memorandum of association include the objects contained in the Schedule to this Act;

(e) satisfies the secretary that the name of the company is in accordance with the rules of the Council and contains the words "Professional Corporation";

(f) satisfies the secretary that the legal and beneficial ownership of all the issued shares of the company is vested in one or more members of the Institute and that all of the directors of the company are members of the Institute;

(g) satisfies the secretary that the persons who will carry on the practice of a chartered accountant on behalf of the company are members of the Institute.

(4) A permit issued under subsection (3) is valid for the period stated thereon.

(5) A permit issued under subsection (3) may be revoked or its renewal withheld by the Council where any of the conditions specified in subsection (3) no longer continue to exist.

(6) For the purposes of subsection (3), clause (g), the practice of a chartered accountant shall not be deemed to be carried on by clerks, secretaries, bookkeepers and other assistants employed by the corporation to perform services which are not usually and ordinarily considered by law, custom and practice to be services which may be performed by a member of the Institute, nor shall the practice of a chartered accountant be deemed to be carried on by registered students employed by the corporation to do any thing in the course of service under articles if it is done under the direction or supervision of a member of the Institute.

Termination of permit

54. Where a professional corporation ceases to fulfil any condition specified in section 53, subsection (3) other than clause (g) by reason only of

(a) the death of a member, or

(b) the striking off or other removal from the register of the name of a member, or

(c) the suspension by the Council of a member,

who is a shareholder of the corporation, the professional corporation has a period of 90 days from the date of the death, striking off, other removal or suspension, as the case may be, in which to fulfil the condition failing which the permit is automatically terminated effective upon the expiration of the 90-day period without the necessity of an order of the Council.

Liability of shareholders and employees

55. (1) Notwithstanding any provision to the contrary in *The Companies Act*, every person who is a shareholder of a corporation during the time that it is the holder of a permit or of a corporation during the time that it practices or acts as a chartered accountant without holding a permit is liable to the same extent and in the same manner as if the shareholder of the corporation were during that time carrying on the business of the corporation as a partnership or, where there is only one shareholder, as an individual practising or acting as a chartered accountant.

(2) The liability of any person in carrying on the practice of or acting as a chartered accountant is not affected

by the fact that the practice of or acting as a chartered accountant is carried on or done by such person as an employee and on behalf of a professional corporation.

Voting agreements with non-members prohibited

56. No shareholder of a professional corporation shall enter into a voting trust agreement, proxy or any other type of agreement vesting in another person who is not a member of the Institute the authority to exercise the voting rights attached to any or all of his shares.

Application of Act and rules

57. The relationship of a member of the Institute or of a registered student to a professional corporation, whether as shareholder, director, officer or employee, does not affect, modify or diminish the application to him of the provisions of this Act and the by-laws and rules.

Preservation of relationships with clients

58. (1) Nothing contained in section 53 shall affect or limit any law applicable to the fiduciary, confidential or ethical relationships between a chartered accountant and a person receiving the professional services of a chartered accountant.

(2) The relationship between a professional corporation carrying on the practice of or acting as a chartered accountant and a person receiving the professional services of the corporation is subject to all applicable law relating to the fiduciary, confidential and ethical relationships between a chartered accountant and his client.

(3) All rights and obligations pertaining to communications made to or information received by a chartered accountant, or his advice thereon, apply to the shareholder, directors, officers and employees of a professional corporation.

Use of title

59. No person or persons shall trade or carry on business within Alberta under any name or title containing the words "Professional Corporation" or the abbreviation "P.C." unless that person or those persons are duly incorporated as a company and the company holds a subsisting permit, or unless otherwise expressly authorized by statute, and every person so trading or carrying on business is guilty of an offence and liable upon summary conviction to a fine not exceeding $25 for every day upon which that name or title has been used.

Application of Act, etc.

60. (1) All the provisions of this Act and the by-laws and rules thereunder which are applicable to chartered accountants apply with all necessary modifications to a professional corporation under this Act unless otherwise expressly provided in this Act.

(2) For the purposes of section 49, the term "member" includes a professional corporation.

Discipline proceedings

61. (1) References in section 38, subsection (3), section 39, subsection (4) and sections 42 and 46 to the suspension of a member shall, in the case of a professional corporation, be deemed a reference to the suspension of the permit of the professional corporation, and the references in section 46, subsection (1), clause (b) and section 48 to striking the name of a member from the register shall, in the case of a professional corporation, be deemed a reference to revocation of the permit of the corporation.

(2) All shareholders, directors, officers and employees of a professional corporation whose conduct is being investigated are compellable witnesses in any proceedings under this Act.

(3) When a professional corporation has been found guilty by the Council of conduct unbecoming a chartered accountant, the Council may

(a) revoke the permit of the corporation, or

(b) suspend for a stated period of time the permit of the corporation, or

(c) reprimand the corporation,

and in addition to a suspension of the permit or a reprimand, the Council may

(d) order the professional corporation to pay for each offence of which it is found guilty, a fine of not more than $1,000 to the Institute, within the time fixed by the Council,

(e) order the professional corporation to pay the costs of the investigation in an amount and within the time fixed by the Council, and

(f) suspend the permit of the corporation in default of paying any fine or costs ordered to be paid until such time as the fine or costs are paid.

Right to sue

62. A corporation may sue for fees for services performed on its behalf and in its name by a person in his capacity as a member at any time after the services are performed, if the services were performed during the time that the corporation was the holder of a subsisting permit.

Evidence

63. A certificate purporting to be signed by the secretary and stating that a named corporation was or was not, on a specified day or during a specified period, a professional corporation according to the records of the Institute, shall be admitted in evidence as prima facie proof of the facts stated therein without proof of the secretary's appointment or signature.

Transitional

64. In any provision of an Act of the Legislature or any regulation, rule, order or by-law made under an Act of the Legislature enacted or made before, at or after the commencement of this section, a reference to a person authorized to carry on the practice of a chartered accountant, whether referred to as a member of the Institute of Chartered Accountants of Alberta, a chartered accountant or otherwise, shall be read as including a professional corporation unless otherwise provided.

Enacts Schedule

(4) The following Schedule is added at the end of the Act:

SCHEDULE

The objects for which the company is established are:

(a) to engage in every phase and aspect of rendering the same services to the public that a chartered accountant, being a member of the Institute of Chartered Accountants of Alberta, is authorized to render;

(b) to purchase or otherwise acquire and to own, mortgage, pledge, sell, assign, transfer or otherwise dispose of, and to invest in, deal in and with, real and personal property necessary for the rendering of the services of a chartered accountant;

(c) to contract debts and borrow money, issue and sell or pledge bonds, debentures, notes and other evidences of indebtedness and execute such mortgages, transfers of corporate property or other instruments to secure the payment of corporate indebtedness as required;

(d) to enter into partnership, consolidate or merge with or purchase the assets of another corporation or individual rendering the same professional services.

The Companies Act

R.S.A. 1970, c. 60

2. (1) The Companies Act is amended by this section.

Amends s. 13

(2) Section 13 is amended by renumbering the section as subsection (1) and by adding the following subsection after subsection (1):

(2) Notwithstanding subsection (1), a company whose objects include the objects contained in the Schedule to *The Legal Profession Act* may be formed under this Act and has power under this Act while it is the holder of a subsisting permit issued under section 113, subsection (3) of *The Legal Profession Act* to execute the office of executor, administrator, trustee, receiver, assignee or liquidator.

Amends s. 15

(3) Section 15 is amended by adding after subsection (3) the following subsection:

(3.1) Any one person who is

(a) a member of the Institute of Chartered Accountants of Alberta, or

(b) a member of the Alberta Dental Association, or

(c) an active member of The Law Society of Alberta, or

(d) a registered practitioner under *The Medical Profession Act, 1975*,

may, by subscribing his name to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company limited by shares, the objects of which shall include the objects contained in the Schedule to *The Chartered Accountants Act, The Dental Association Act, The Legal Profession Act* or *The Medical Profession Act, 1975*, as the case may be.

Amends s. 16

(4) Section 16 is amended by renumbering the section as subsection (1) and by adding the following subsections:

(2) Notwithstanding subsection (1), clause (a), a company limited by shares

(a) may be incorporated under a name which does not include the word "Limited" or "Ltd.", and

(b) may change its name in accordance with section 32 to exclude the word "Limited" or "Ltd.",

if the company is incorporated, or its name is changed, as the case may be, for the purpose of making application for the issuance of a permit to operate as a professional corporation under *The Chartered Accountants Act, The Dental Association Act, The Legal Profession Act* or *The Medical Profession Act, 1975* and if the company undertakes to change its name to include the word "Limited" or "Ltd." within 90 days after the company ceases to hold a subsisting permit.

(3) The Registrar, after having given notice to the company of his intention to do so, may by order change the name of a company limited by shares to include the word "Limited" or "Ltd." if it is shown to the satisfaction of the Registrar that the company has carried on business for a period exceeding 90 days while not the holder of a subsisting permit as a professional corporation issued under *The Chartered Accountants Act, The Dental Association Act, The Legal Profession Act* or *The Medical Profession Act, 1975*.

(4) A notice given by the Registrar under subsection (3) shall be subject to appeal in accordance with section 12.

(5) Notwithstanding subsection (1), clause (c), the memorandum of a company the objects of which include the objects contained in the Schedule to *The Chartered Accountants Act, The Dental Association Act, The Legal Profession Act* or *The Medical Profession Act, 1975* shall state

that the liability of the members is limited except in the circumstances described in section 55, subsection (1) of *The Chartered Accountants Act*, section 72, subsection (1) of *The Dental Association Act*, section 115, subsection (1) of *The Legal Profession Act* or section 89, subsection (1) of *The Medical Profession Act, 1975*.

Amends s. 293

(5) Section 293 is amended by renumbering the section as subsection (1) and by adding the following subsection:

(2) Subsection (1) does not apply to a company formed pursuant to section 15, subsection (3.1).

The Dental Association Act

R.S.A. 1970, c. 90

3. (1) The Dental Association Act is amended by this section.

Amends s. 2

(2) Section 2 is amended by adding after clause (d) the following clauses:

(d1) "permit" means a permit issued pursuant to section 70, subsection (3);

(d2) "professional corporation" means the holder of a subsisting permit;

Amends s. 50

(3) Section 50, subsection (1) is amended by striking out the words "No company" *and by substituting therefor the words* "Subject to section 70, no company".

Enacts ss. 69-81

(4) The following sections are added after section 68:

Professional Corporations

By-laws

69. The board may make by-laws

(a) prescribing the manner of proof as to matters required to be proven by applicants for permits;

(b) fixing the fees payable to the Association for the issuance of permits and the fees payable annually by professional corporations;

(c) providing that the permit of a professional corporation is suspended without notice or investigation upon contravention of any by-law that requires the corporation to pay a fee or assessment, file a document or do any other act by a specified or ascertainable date, and providing for the reinstatement of a permit so suspended;

(d) providing for the reinstatement or re-issuance of any permit suspended or revoked pursuant to an order of the board under section 77 and prescribing the terms and conditions upon which reinstatement or re-issuance of a permit may be granted;

(e) providing for the creation and maintenance of a register of professional corporations and requiring the filing of periodic returns by such corporations;

(f) providing for the annual renewal of permits and prescribing the terms and conditions upon which renewals may be granted;

(g) prescribing the types of names by which a

(i) professional corporation, or

(ii) a partnership of two or more professional corporations, or

(iii) a partnership of one or more professional corporations and one or more dentists or dental surgeons,

may be known.

Permit

70. (1) Notwithstanding any other provision of this Act, a corporation to which a permit is issued under this section may practice dentistry and dental surgery in its own name.

(2) Notwithstanding subsection (1), no corporation shall be enrolled as a member of the Association.

(3) The registrar shall issue a permit to any corporation which fulfils the following conditions:

(a) files an application in the form prescribed by the board;

(b) pays all the fees prescribed by the board;

(c) satisfies the registrar that it is a company limited by shares that is in good standing with the Registrar of Companies under *The Companies Act*;

(d) satisfies the registrar that the objects of the company stated in its memorandum of association include the objects contained in the Schedule to this Act;

(e) satisfies the registrar that the name of the company is in accordance with the by-laws of the Association and contains the words "Professional Corporation";

(f) satisfies the registrar that the legal and beneficial ownership of all the issued shares of the company is vested in one or more members of the Association and that all of the directors of the company are members of the Association;

(g) satisfies the registrar that the persons who will carry on the practice of dentistry and dental surgery on behalf of the company are members of the Association.

(4) A permit issued under subsection (3) expires on December 31 of the year for which it was issued.

(5) A permit issued under subsection (3) may be revoked or its renewal withheld by the board where any of the conditions specified in subsection (3) no longer continue to exist.

(6) For the purposes of subsection (3), clause (g), the practice of dentistry or dental surgery shall not be deemed to be carried on by clerks, secretaries, bookkeepers, hygienists, dental assistants or other assistants employed by the corporation to perform services which are not usually and ordinarily considered by law, custom and practice to be services which may be performed only by a member of the Association.

Termination of permit

71. Where a professional corporation ceases to fulfil any condition specified in section 70, subsection (3) by reason only of

(a) the death of a member, or

(b) removal of a member's name from the register, or

(c) the suspension by the Association of a member,

who is a shareholder of the corporation, the professional corporation has a period of 90 days from the date of death, striking off or suspension, as the case may be, in which to fulfil the condition failing which the permit is automatically terminated effective upon the expiration of the 90-day period without the necessity of an order of the board.

Liability of shareholders and employees

72. (1) Notwithstanding any provision to the contrary in *The Companies Act*, every person who is a shareholder of a corporation during the time that it is the holder of a permit or of a corporation during the time that it acts in contravention of the provisions of section 47, subsection (1) or of section 50, 52 or 54 is liable to the same extent and in the same manner as if the shareholders of the corporation were during that time carrying on the business of the corporation as a partnership or, where there is only one shareholder, as an individual practising dentistry or dental surgery.

(2) The liability of any person in carrying on the practice of dentistry or dental surgery is not affected by the fact that the practice of dentistry or dental surgery is carried on by such person as an employee and on behalf of a professional corporation.

Voting agreements with non-members prohibited

73. No shareholder of a professional corporation shall enter into a voting trust agreement, proxy or any other type of agreement vesting in another person who is not a member of the Association the authority to exercise the voting rights attached to any or all of his shares.

Application of Act and by-laws

74. The relationship of a member of the Association to a professional corporation, whether as a shareholder, director, officer or employee, does not affect, modify or diminish the application to him of the provisions of this Act and the by-laws.

Use of title

75. No person or persons shall trade or carry on business within Alberta under any name or title containing the words "Professional Corporation" or the abbreviation "P.C." unless that person or those persons are duly incorporated as a company and the company holds a subsisting permit, or unless otherwise expressly authorized by statute, and every person so trading or carrying on business is guilty of an offence and liable upon summary conviction to a fine not exceeding $25 for every day upon which that name or title has been used.

Application of Act and by-laws

76. (1) All the provisions of this Act and the by-laws which are applicable to members apply with all necessary modifications to a professional corporation under this Act unless otherwise expressly provided in this Act.

(2) Sections 50, 52 and 54 do not apply to a professional corporation.

Discipline proceedings

77. (1) References in section 32 or 39 to the suspension of a member shall, in the case of a professional corporation, be deemed a reference to the suspension of a permit of the professional corporation, and references in section 32 to removing the name of a member from the register shall, in the case of a professional corporation, be deemed a reference to revocation of the permit of the corporation.

(2) All shareholders, directors, officers and employees of a professional corporation whose conduct is being investigated are compellable witnesses in any proceedings under this Act.

(3) When a professional corporation has been found guilty by the board under this Act of unbecoming, improper or unprofessional conduct, the board may

(a) revoke the permit of the corporation, or

(b) suspend for a stated period of time the permit of the corporation, or

(c) reprimand the corporation,

and in addition to a suspension of the permit or a reprimand, the board may

(d) order the professional corporation to pay for each offence of which it is found guilty, a fine of not more than $1,000 to the Association, within the time fixed by the order,

(e) order the professional corporation to pay the costs of the investigation in an amount and within the time fixed by the board, and

(f) suspend the permit of the corporation in default of paying any fine or costs ordered to be paid until such time as the fine or costs are paid.

Right to sue

78. A corporation may sue for fees for services performed on its behalf and in its name by a person in his capacity as an active member at any time after the services are performed, if the services were performed during the time that the corporation was the holder of a subsisting permit.

Employment of suspended member

79. (1) No professional corporation shall, except under the authority of a resolution of the board, employ in connection with its practice, a suspended member or a member whose name has been struck off the register.

(2) The board may by resolution permit a professional corporation to employ in connection with its practice a suspended member or a member whose name has been struck off the register but the employment shall be in the capacity and subject to the terms and conditions that the resolution prescribes.

Evidence

80. A certificate purporting to be signed by the registrar and stating that a named corporation was or was not, on a specified day or during a specified period, a professional corporation according to the records of the Association, shall be admitted in evidence as prima facie proof of the facts stated therein without proof of the registrar's appointment or signature.

Transitional

81. In any provision of an Act of the Legislature or any regulation, rule, order or by-law made under an Act of the Legislature enacted or made before, at or after the commencement of this section, a reference to a person authorized to carry on the practice of dentistry or dental surgery, whether referred to as a member of The Alberta Dental Association, a dentist or dental surgeon or otherwise, shall be read as including a professional corporation unless otherwise expressly provided.

Enacts Schedule

(5) The following Schedule is added at the end of the Act:

SCHEDULE

The objects for which the company is established are

(a) to engage in every phase and aspect of rendering the same dental services to the public that a dentist

or dental surgeon, being a member of The Alberta Dental Association, is authorized to render;

(b) to purchase or otherwise acquire and to own, mortgage, pledge, sell, assign, transfer or otherwise dispose of, and to invest in, deal in and with, real and personal property necessary for the rendering of dental services;

(c) to contract debts and borrow money, issue and sell or pledge bonds, debentures, notes and other evidences of indebtedness and execute such mortgages, transfers of corporate property or other instruments to secure the payment of corporate indebtedness as required;

(d) to enter into partnership, consolidate or merge with or purchase the assets of another corporation or individual rendering the same professional services.

The Legal Profession Act

R.S.A. 1970, c. 203

4. (1) The Legal Profession Act is amended by this section.

Enacts Part 8

(2) The following Part is added after section 110:

PART 8

PROFESSIONAL CORPORATIONS

Definitions

111. In this Part,

(a) "permit" means a permit issued pursuant to section 113, subsection (3);

(b) "professional corporation" means the holder of a subsisting permit.

Rules by Benchers

112. The Benchers may make rules

(a) prescribing the manner of proof as to matters required to be proven by applicants for permits;

(b) fixing the fees payable to the Society for the issuance of permits and the fees payable annually by professional corporations;

(c) providing that the permit of a professional corporation is suspended without notice or investigation upon contravention of any rule that requires the corporation to pay a fee or assessment, file a document or do any other act by a specified or ascertainable date, and providing for the reinstatement of a permit so suspended;

(d) providing for the reinstatement or re-issuance of any permit suspended or revoked pursuant to an

order of the Benchers under section 121 and prescribing the terms and conditions upon which reinstatement or re-issuance of a permit may be granted;

(e) requiring professional corporations to open and maintain trust accounts for clients' money at a chartered bank, a treasury branch or a corporation that is an approved corporation under *The Trustee Act;*

(f) requiring professional corporations to keep books of account and records containing particulars and information as to moneys received, held or paid for or on account of clients, requiring the furnishing of evidence that those accounts and records are being kept and maintained and providing for the inspection of those books and records from time to time by the officers, auditors or agents of the Society;

(g) requiring any professional corporation to pay to the Society the cost of any inspection or audit of its books and accounts where the rules under clause (e) or (f) have not been complied with,

(h) providing for the creation and maintenance of a register of professional corporations and requiring the filing of periodic returns by such corporations;

(i) providing for the annual renewal of permits and prescribing the terms and conditions upon which renewals may be granted;

(j) prescribing the types of names by which

(i) a professional corporation, or

(ii) a partnership of two or more professional corporations, or

(iii) a partnership of one or more professional corporations and one or more individual barristers and solicitors,

may be known.

Permit

113. (1) Notwithstanding any other provision of this Act, a corporation to which a permit is issued under this section may practice law in its own name.

(2) Notwithstanding subsection (1), no corporation shall be enrolled as a member of the Society.

(3) The Secretary shall issue a permit to any corporation which fulfils the following conditions:

(a) files an application in the form prescribed by the Benchers;

(b) pays all the fees prescribed by the Benchers;

(c) satisfies the Secretary that it is a company limited by shares that is in good standing with the Registrar of Companies under *The Companies Act;*

(d) satisfies the Secretary that the objects of the company stated in its memorandum of association include the objects contained in the Schedule to this Act;

(e) satisfies the Secretary that the name of the company is in accordance with the rules of the Society and contains the words "Professional Corporation";

(f) satisfies the Secretary that the legal and beneficial ownership of all the issued shares of the company is vested in one or more active members of the Society and that all of the directors of the company are active members of the Society;

(g) satisfies the Secretary that the persons who will carry on the practice of a barrister and solicitor on behalf of the company are active members of the Society.

(4) A permit issued under subsection (3) expires on December 31 of the year for which it was issued.

(5) A permit issued under subsection (3) may be revoked or its renewal withheld by the Benchers where any of the conditions specified in subsection (3) no longer continue to exist.

(6) For the purposes of subsection (3), clause (g), the practice of a barrister and solicitor shall not be deemed to be carried on by clerks, secretaries, bookkeepers and other assistants employed by the corporation to perform services which are not usually and ordinarily considered by law, custom and practice to be services which may be performed only by an active member of the Society, nor shall the practice of a barrister and solicitor be deemed to be carried on by articled students-at-law employed by the corporation to do any thing in the course of service under articles if it is done under the direction or supervision of an active member of the Society.

Termination of permit

114. Where a professional corporation ceases to fulfil any condition specified in section 113, subsection (3) by reason only of the death or loss of active membership in the Society of a shareholder of the company, the professional corporation has a period of 90 days from the date of the death or loss of active membership, as the case may be, in which to fulfil the condition failing which the permit is automatically terminated effective upon the expiration of

the 90-day period without the necessity of an order of the Benchers.

Liability of shareholders and employees

115. (1) Notwithstanding any provision to the contrary in *The Companies Act*, every person who is a shareholder of a corporation during the time that it is the holder of a permit or of a corporation during the time that it acts in contravention of the provisions of section 92, subsection (1), is liable to the same extent and in the same manner as if the shareholders of the corporation were during that time carrying on the business of the corporation as a partnership or, where there is only one shareholder, as an individual practising as a barrister and solicitor.

(2) The liability of any person in carrying on the practice of a barrister and solicitor is not affected by the fact that the practice of a barrister and solicitor is carried on by such person as an employee and on behalf of a professional corporation.

Voting agreements with non-members prohibited

116. No shareholder of a professional corporation shall enter into a voting trust agreement, proxy or any other type of agreement vesting in another person who is not an active member of the Society the authority to exercise the voting rights attached to any or all of his shares.

Application of Act and rules

117. The relationship of a member of the Society or of a student-at-law to a professional corporation, whether as shareholder, director, officer or employee, does not affect, modify or diminish the application to him of the provisions of this Act and the rules.

Preservation of solicitor-client relationships

118. (1) Nothing contained in section 113 shall affect, modify or limit any law applicable to the fiduciary, confidential or ethical relationships between a barrister and solicitor and a person receiving the professional services of a barrister and solicitor.

(2) The relationship between a professional corporation carrying on the practice of a barrister and solicitor and a person receiving the professional services of the corporation is subject to all applicable law relating to the fiduciary, confidential and ethical relationships between a barrister and solicitor and his client.

(3) All rights and obligations pertaining to communications made to or information received by a barrister and solicitor, or his advice thereon, apply to the shareholders, directors, officers and employees of a professional corporation.

Use of title

119. No person or persons shall trade or carry on business within Alberta under any name or title containing the words "Professional Corporation" or the abbreviation "P.C." unless that person or those persons are duly incorporated as a company and the company holds a subsisting permit, or unless otherwise expressly authorized by statute, and every person so trading or carrying on business is guilty of an offence and liable upon summary conviction to a fine not exceeding $25 for every day upon which that name or title has been used.

Application of Act and rules

120. (1) All the provisions of Parts 3, 4 and 5 and the rules thereunder which are applicable to barristers and solicitors apply with all necessary modifications to a professional corporation under this Part unless otherwise expressly provided in this Part.

(2) The following provisions of this Act do not apply to a professional corporation:

section 73, subsection (2);
section 92, subsection (1);
section 93, subsections (1) and (2).

(3) For the purposes of sections 100, 101 and 109, the term "member" includes a professional corporation.

Discipline proceedings

121. (1) References in section 56, section 64, subsection (2) and section 73, subsection (1) to the suspension of a member shall, in the case of a professional corporation, be deemed a reference to the suspension of the permit of the professional corporation, and references in section 73, subsection (1), clause (b) and section 75, subsections (1) and (3) to striking the name of a member from the roll shall, in the case of a professional corporation, be deemed a reference to revocation of the permit of the corporation.

(2) All shareholders, directors, officers and employees of a professional corporation whose conduct is being investigated are compellable witnesses in any proceedings under Part 3.

(3) When a professional corporation has been found guilty by the Benchers under Part 3 of conduct unbecoming a barrister and solicitor, the Benchers may

(a) revoke the permit of the corporation, or

(b) suspend for a stated period of time the permit of the corporation, or

(c) reprimand the corporation,

and in addition to a suspension of the permit or a reprimand, the Benchers may

(d) order the professional corporation to pay for each offence of which it is found guilty, a fine of not

more than $1,000 to the Society, within the time fixed by the order,

(e) order the professional corporation to pay the costs of the investigation in an amount and within the time fixed by the Benchers, and

(f) suspend the permit of the corporation in default of paying any fine or costs ordered to be paid until such time as the fine or costs are paid.

Assurance Fund and custodian provisions

122. (1) The misappropriation or wrongful conversion referred to in section 76, subsection (1) includes misappropriation or wrongful conversion by a member of the Society of money or other property entrusted to or received by any professional corporation in its capacity as a barrister and solicitor, of which corporation such member is a shareholder, director, officer or employee.

(2) An order authorized to be made by a judge of the Supreme Court in the case of a member under section 82, subsection (1) may, in the case of a professional corporation, be made in any of the following cases, namely,

(a) when the permit of the corporation has been revoked or suspended under section 121, subsection (3), or

(b) when a shareholder of the corporation has died or become mentally incapacitated, or

(c) when for any reason the corporation is unable to practice as a barriser and solicitor, or

(d) when a shareholder of the corporation has absconded or is otherwise improperly absent from the corporation's place of business, or the corporation has neglected its practice for an unduly extended period, or

(e) when there is reason to believe that the trust moneys held by the corporation are not sufficient to meet its trust liabilities, or

(f) when sufficient grounds otherwise exist.

Municipal licence unnecessary

123. No municipality has the power to require any professional corporation to obtain a licence from the municipality to practice law or to carry on the practice or profession of a barrister and solicitor.

Right to sue

124. A corporation may sue for fees for services performed on its behalf and in its name by a person in his capacity as an active member at any time after the services are performed, if the services were performed during the time that the corporation was the holder of a subsisting permit.

Employment of suspended members

125. (1) No professional corporation shall, except under the authority of a resolution of the Benchers, employ in connection with its practice a suspended member or a member whose name has been struck off the roll.

(2) The Benchers may by resolution permit a professional corporation to employ in connection with its practice a suspended member or a member whose name has been struck off the roll but the employment shall be in the capacity and subject to the terms and conditions that the resolution prescribes.

Evidence

126. A certificate purporting to be signed by the Secretary and stating that a named corporation was or was not, on a specified day or during a specified period, a professional corporation according to the records of the Society, shall be admitted in evidence as prima facie proof of the facts stated therein without proof of the Secretary's appointment or signature.

Transitional

127. In any provision of an Act of the Legislature or any regulation, rule, order or by-law made under an Act of the Legislature enacted or made before, at or after the commencement of this section, a reference to a person authorized to carry on the practice of law, whether referred to as a member of The Law Society of Alberta, a barrister and solicitor or otherwise, shall be read as including a professional corporation unless otherwise expressly provided.

Enacts Schedule

(3) The following Schedule is added at the end of the Act:

SCHEDULE

The objects for which the company is established are

(a) to engage in every phase and aspect of rendering the same legal services to the public that a barrister and solicitor, being an active member of The Law Society of Alberta, is authorized to render;

(b) to purchase or otherwise acquire and to own, mortgage, pledge, sell, assign, transfer or otherwise dispose of, and to invest in, deal in and with, real and personal property necessary for the rendering of legal services;

(c) to contract debts and borrow money, issue and sell or pledge bonds, debentures, notes and other evidences of indebtedness and execute such mortgages, transfers of corporate property or other instruments to secure the payment of corporate indebtedness as required;

(d) to enter into partnership, consolidate or merge with or purchase the assets of another corporation or individual rendering the same professional services.

The Medical Profession Act, 1975

1975, c. 26

5. (1) The Medical Profession Act, 1975 is amended by this section.

Enacts Part 6

(2) The following Part is added after section 84:

PART 6

PROFESSIONAL CORPORATIONS

Definitions

85. In this Part,

(a) "permit" means a permit issued pursuant to section 87, subsection (3);

(b) "professional corporation" means the holder of a subsisting permit.

By-laws

86. The council may make by-laws

(a) prescribing the manner of proof as to matters required to be proven by applicants for permits;

(b) fixing the fees payable to the College for the issuance of permits and the fees payable annually by professional corporations;

(c) providing that the permit of a professional corporation is suspended without notice or investigation upon contravention of any by-law that requires the corporation to pay a fee or assessment, file a document or do any other act by a specified or ascertainable date, and providing for the reinstatement of a permit so suspended;

(d) providing for the reinstatement or re-issuance of any permit suspended or revoked pursuant to an order of the council under section 95 and prescribing the terms and conditions upon which reinstatement or re-issuance of a permit may be granted;

(e) providing for the creation and maintenance of a register of professional corporations and requiring the filing of periodic returns by such corporations;

(f) providing for the annual renewal of permits and prescribing the terms and conditions upon which renewals may be granted;

(g) prescribing the types of names by which

(i) a professional corporation, or

(ii) a partnership of two or more professional corporations, or

(iii) a partnership of one or more professional corporations and one or more individual practitioners,

may be known.

Permit

87. (1) Notwithstanding any other provision of this Act, a corporation to which a permit is issued under this section may practice medicine in its own name.

(2) Notwithstanding subsection (1), no corporation shall be enrolled as a registered practitioner.

(3) The registrar shall issue a permit to any corporation which fulfils the following conditions:

(a) files an application in the form prescribed by the council;

(b) pays all the fees prescribed by the council;

(c) satisfies the registrar that it is a company limited by shares that is in good standing with the Registrar of Companies under *The Companies Act;*

(d) satisfies the registrar that the objects of the company stated in its memorandum of association include the objects contained in the Schedule to this Act;

(e) satisfies the registrar that the name of the company is in accordance with the by-laws of the council and contains the words "Professional Corporation";

(f) satisfies the registrar that the legal and beneficial ownership of all the issued shares of the company is vested in one or more registered practitioners and that all of the directors of the company are registered practitioners;

(g) satisfies the registrar that the persons who will carry on the practice of medicine on behalf of the company are registered practitioners.

(4) A permit issued under subsection (3) expires on December 31 of the year for which it was issued.

(5) A permit issued under subsection (3) may be revoked or its renewal withheld by the council where any of the conditions specified in subsection (3) no longer continue to exist.

(6) For the purposes of subsection (3), clause (g), the practice of a registered practitioner shall not be deemed to be carried on by clerks, secretaries, nurses and other assistants employed by the corporation to perform services which are not usually and ordinarily considered by law, custom and practice to be services which may be performed only by a registered practitioner.

Termination of permit

88. Where a professional corporation ceases to fulfil any condition specified in section 87, subsection (3) by reason only of

(a) the death of a registered practitioner, or

(b) the striking off or other removal from the register of the name of a registered practitioner, or

(c) the suspension of a registered practitioner by the College,

who is a shareholder of the corporation, the professional corporation has a period of 90 days from the date of death, striking off or other removal or the suspension, as the case may be, in which to fulfil the condition failing which the permit is automatically terminated effective upon the expiration of the 90-day period without the necessity of an order of the council.

Liability of shareholders and employees

89. (1) Notwithstanding any provision to the contrary in *The Companies Act*, every person who is a shareholder or a corporation during the time that it is the holder of a permit or of a corporation during the time that it acts in contravention of the provisions of section 64, subsection (1), is liable to the same extent and in the same manner as if the shareholders of the corporation were during that time carrying on the business of the corporation as a partnership or, where there is only one shareholder, as an individual practising medicine.

(2) The liability of any person in carrying on the practice of medicine is not affected by the fact that the practice of medicine is carried on by such person as an employee and on behalf of a professional corporation.

Voting agreements with non-members prohibited

90. No shareholder of a professional corporation shall enter into a voting trust agreement, proxy or any other type of agreement vesting in another person who is not a registered practitioner the authority to exercise the voting rights attached to any or all of his shares.

Application of Act and by-laws

91. The relationship of a registered practitioner to a professional corporation, whether as shareholder, director, officer or employee, does not affect, modify or diminish the application to him of the provisions of this Act and the by-laws.

Preservation of doctor-patient relationship

92. (1) Nothing contained in section 87 shall affect, modify or limit any law applicable to the confidential or ethical relationships between a registered practitioner and a person receiving the professional services of a registered practitioner.

(2) The relationship between a professional corporation carrying on the practice of medicine and a person receiving the professional services of the corporation is subject to all applicable law relating to the confidential and ethical relationships between a registered practitioner and his patient.

(3) All rights and obligations pertaining to communications made to or information received by, a registered practitioner apply to the shareholders, directors, officers and employees of a professional corporation.

Use of title

93. No person or persons shall trade or carry on business within Alberta under any name or title containing the words "Professional Corporation" or the abbreviation "P.C." unless that person or those persons are duly incorporated as a company and the company holds a subsisting permit, or unless otherwise expressly authorized by statute, and every person so trading or carrying on business is guilty of an offence and liable upon summary conviction to a fine not exceeding $25 for every day upon which that name or title has been used.

Application of Act and Rules

94. (1) All of the provisions of Parts 3, 4 and 5 and the by-laws thereunder which are applicable to members of the College apply with all necessary modifications to a professional corporation under this Part unless otherwise expressly provided in this Part.

(2) The following provisions of this Act do not apply to a professional corporation:

section 64, subsection (1);
section 69;
section 70.

Disciplinary proceedings

95. (1) References in this Act to the suspension of a member shall, in the case of a professional corporation, be deemed a reference to the suspension of the permit of the professional corporation, and references in this Act to striking the name of a registered practitioner from the register shall, in the case of a professional corporation, be deemed a reference to revocation of the permit of the corporation.

(2) All shareholders, directors, officers and employees of a professional corporation whose conduct is being investigated are compellable witnesses in any proceedings under Part 3.

(3) When a professional corporation has been found guilty by the council under Part 3 of unbecoming conduct, the council may

(a) revoke the permit of the corporation, or

(b) suspend for a stated period of time the permit of the corporation, or

(c) reprimand the corporation,

and in addition to a suspension of the permit or a reprimand, the council may

(d) order the professional corporation to pay for each offence of which it is found guilty, a fine of not more than $1,000 to the College, within the time fixed by the order,

(e) order the professional corporation to pay the costs of the investigation in an amount and within the time fixed by the council, and

(f) suspend the permit of the corporation in default of paying any fine or costs ordered to be paid until such time as the fine or costs are paid.

Municipal licence unnecessary

96. No municipality has the power to require any professional corporation to obtain a licence from the municipality to practice medicine.

Right to sue

97. A corporation may sue for fees for services performed on its behalf and in its name by a person in his capacity as a registered practitioner at any time after the services are performed, if the services were performed during the time that the corporation was the holder of a subsisting permit.

Evidence

98. A certificate purporting to be signed by the registrar and stating that a named corporation was or was not, on a specified day or during a specified period, a professional corporation according to the records of the College, shall be admitted in evidence as prima facie proof of the facts stated therein without proof of the registrar's appointment or signature.

Transitional

99. In any provision of an Act of the Legislature or any regulation, rule, order or by-law made under an Act of the Legislature enacted or made before, at or after the commencement of this section, a reference to a person authorized to carry on the practice of medicine, whether referred to as a registered practitioner, physician or any like words or expressions implying legal recognition of a person as being entitled to practise medicine, shall be read as including a professional corporation unless otherwise expressly provided.

Enacts Schedule

(3) The following Schedule is added at the end of the Act:

SCHEDULE

The objects for which the company is established are

(a) to engage in every phase and aspect of rendering the same medical services to the public that a registered practitioner of the College of Physicians and Surgeons of the Province of Alberta is authorized to render;

(b) to purchase or otherwise acquire and to own, mortgage, pledge, sell, assign, transfer or otherwise dispose of, and to invest in, deal in or with, real or personal property necessary for the rendering of medical services;

(c) to contract debts and borrow money, issue and sell or pledge bonds, debentures, notes and other evi-

dences of indebtedness and execute such mortgages, transfers of corporate property and other instruments to secure the payment of corporate indebtedness as required;

(d) to enter into partnership, consolidate or merge with or purchase the assets of another corporation or individual rendering the same professional services.

The Trust Companies Act

R.S.A. 1970, c. 372

6. (1) The Trust Companies Act is amended by this section.

Amends s. 2

(2) Section 2, subsection (1), clause 5 is amended by adding after the word "powers" *the words* "but does not include a corporation whose objects include the objects contained in the Schedule to *The Legal Profession Act* and all issued shares of which are legally and beneficially owned by active members of The Law Society of Alberta".

Coming into force

7. This Act comes into force on the day upon which it is assented to.

APPENDIX C

LAWYERS

APPENDIX C–1

American Bar Association

Opinion 303 November 27, 1961

Lawyers who practice law in a form of organization usually designated by a professional association or professional corporation, which has the characteristics in whole or in part, of limited liability, centralized management, continuity of life, and transferability of interests, may be, but are not necessarily, acting in violation of one or more of the Canons. The mere fact that the form of organization used by lawyers to practice law is a professional association or professional corporation does not in and of itself constitute a violation of any canon as it is the substance of the arrangement and not the form that is controlling.

CANONS 31, 33, 34, 35, 37, 47

OPINIONS 277, 283

Numerous inquiries have been received by this Committee in regard to the appropriateness from an ethical standpoint of lawyers carrying on the practice of law in a form that will be classified as a corporation for federal income tax purposes. Statutory provisions now exist in several states which are designed to make this legally possible, either as a result of lawyers incorporating or forming associations with various corporate characteristics. This Opinion will assume that such legislation is valid and is not intended to eliminate the ethical restraints imposed on the legal profession by the Canons of Ethics.

It is not the purpose of this Opinion to express any judgment as to whether any particular professional association or professional corporation will be classified as a corporation for federal income tax purposes. It should be noted, however, that there may be some doubt whether the various statutes enacted in 1961 in relation to professional associations and professional corporations will result in such associations or corporations being classified as corporations for federal income tax purposes. It is not the purpose of this Opinion to state what federal income tax advantages will be available to a group of lawyers if the form of organization adopted by them for the practice of law is treated as a corporation for federal income tax purposes.

Furthermore, this Opinion is not concerned with the wisdom or feasibility of lawyers adopting, as a form of organization for the practice of law, the professional association or professional corporation. However, it should be said that upon this subject, the members of the Committee have grave doubts.

This Opinion will deal with the general characteristics which are typically present, in whole or in part, when a professional association or professional corporation designed to qualify for classification as a corporation for federal income tax purposes is formed and will pass on the ethical problems presented by these general characteristics where lawyers are concerned. The Committee will no doubt be called upon to express itself from time to time on the application of this Opinion to specific situations which may be presented to it.

The general characteristics which the professional association or professional corporations have in varying degrees are limited liability, centralized management, continuity of life, and free transferability of interests. It is these characteristics that are stressed in determining whether any organization will be deemed a corporation for federal income tax purposes. Can lawyers carry on the practice of law under a form of organization having these characteristics, in whole or in part, without being in violation of one or more of the Canons of Ethics?

In answering this question, the substance of an arrangement is controlling, not the form. In other words, the mere fact that the form of organization used by lawyers to practice law is a professional association (other than the orthodox partnership) or is a professional corporation does not in and of itself constitute a violation of any Canon. A look behind the form to the substance is required to ascertain whether any Canon is violated.

Canon 35 states that a lawyer's relation to his client should be personal, and the responsibility should be direct to the client. The close lawyer-client relationship which Canon 35 is designed to foster cannot be attained unless the client's reasonable expectations as to the scope of the responsibility for the legal services being rendered is a reality.

Canon 33 provides that in the selection and use of a firm name, no false, misleading, assumed or trade name should be used. The name under which a group of lawyers practices would be misleading if it failed to reveal any restrictions on the responsibility of the individual lawyers for the legal services rendered.

In formal Opinion 253, it is stated:

> There can be no distinction in principle between a transfer to a corporation and to trustees. In either case, the firm property, tangible and intangible, no longer belongs to the partnership. Be that as it may, the proposed plan would result in an arrangement whereby a group of associates, not true partners *intersese* as we think, are masquerading as a partnership, since the inquiry states the firm name would be continued, a violation of *Canon 33* and condemned in *Opinion 277*.

If a professional association or professional corporation is organized to practice law and the lawyers other than the ones rendering the legal services to a client are not under any personal liability therefor, the fees collected for the legal work will nevertheless go to the association or corporation and in due course will be shared by all the lawyers in the organization. Canon 34 permits

a division of legal fees for legal services with another lawyer if the division is based upon a division of service or responsibility. All lawyers within an organization bear a professional responsibility for the legal services of the organization, whether they are under any personal legal liability for all of such services or not. This general professional responsibility of all, though legal liability is limited, prevents any violation of Canon 34, when the lawyers in the organization are entitled to share in the fees collected without regard to whether they personally participated in the rendition of the legal services.

The comments above make it clear that it is possible for lawyers to engage in the practice of law under a form of organization that imposes limited liability without violating any of the Canons of Ethics if the following safeguards are observed:

1. The lawyer or lawyers rendering the legal services to the client must be personally responsible to the client.

2. Restrictions on liability as to other lawyers in the organization must be made apparent to the client.

Centralized management of a group of lawyers organized to practice law can mean many different things. Orthodox partnership arrangements involving lawyers may involve managing partners who have authority under the partnership articles to make decisions for the partnership in regard to many matters. Opinions carrying the firm name may have to be approved by certain senior partners.

Canon 31 provides that every lawyer on his own responsibility must decide what employment he will accept as counsel, what causes he will bring into court for plaintiffs, what cases he will contest in court for defendants. If the form of organization under which a group of lawyers is practicing has a central committee that makes these decisions for all lawyers in the organization, this does not involve a violation of Canon 31, if the central committee making the decisions is and can only be made up of lawyers. Canon 31 is designed to prevent non-lawyer direction of lawyer work.

Canon 33, though in terms it refers to partnerships, promulgates underlying principles that must be observed no matter in what form of organization lawyers practice law. Its requirement that no person should be admitted or held out as a practitioner or member who is not a member of the legal profession duly authorized to practice, and amenable to professional discipline, makes it clear that any centralized management must be in lawyers to avoid a violation of this Canon. This is also bolstered by the paragraph in this Canon which states:

> Partnerships between lawyers and members of other professions or non-professional persons should not be formed or permitted where any part of the partnership's employment consists of the practice law.

Canon 35 provides that services of a lawyer should not be controlled or exploited by any lay agency, personal or corporate, which intervenes between

client and lawyer. There is no intervention of any lay agency between lawyer and client when centralized management provided only by lawyers may give guidance or direction to the services being rendered by a lawyer-member of the organization to a client. The language in Canon 35 that a lawyer should avoid all relations which direct the performance of his duties by or in the interest of an intermediary refers to lay intermediaries and not lawyer intermediaries with whom he is associated in the practice of law.

In formal Opinion 283, which considered the ethical appropriateness of a group of associates practicing law under a form of organization sometimes referred to as a Massachusetts Trust, it is stated:

> As "the present partners will convey their interest in the partnership to three trustees," and the trustees shall hold title to the property and have power to sell or dispose of the same and to employ professional or non-professional assistants, a violation of *Canon 35* would seem to follow. If the trustees are to pay for the services of others in the office, then it would appear that all fees must be paid to the trustees, especially as all the partners had conveyed their interests in the partnership to the trustees. The result would be, in spite of the inquirer's assertion that "the lawyer-client relationship will be the same," that an intermediary—to-wit, the "trust", which would seem to have some of the attributes of a corporation—would intervene between at least some of the associates and clients, thereby violating several provisions of *Canon 35*.

The language quoted above from Opinion 283 does not mean that the mere fact that there is centralized management under a form of organization that creates some kind of legal entity distinct from the members of the organization results in an intervention between the client and his lawyer in violation of Canon 35. As long as the centralized management can only be in lawyers, the existence of centralized management will not result in a violation of the Canon. When the centralized management must be in lawyers, the intervention is basically no different than that which takes place in a law partnership where some of the partners have managing responsibilities and where a procedure exists for clearing advice to clients with senior partners.

Centralized management will give the managers access to a client's confidences. Canon 37 imposes upon the lawyer the duty to preserve his client's confidences. As long as the managers are and can only be lawyers, they would clearly be under the same duty to preserve the confidence as the lawyer who elicited them and thus the protection of the client which Canon 37 is designed to provide is preserved.

Canon 47 prohibits a lawyer from permitting his professional services, or his name, to be used in aid of, or to make possible, the unauthorized practice of the law by any lay agency, personal or corporate. The professional association or professional corporation, though an entity distinct from its members, even though governed by a central committee, is not a lay agency if the committee does and can only consist of lawyers. Thus no violation of Canon

47 is involved merely because the form of organization provides for centralized management by lawyers.

The preceding discussion justifies the general conclusion that centralized management, by lawyers exclusively, of a professional association or professional corporation set up to practice law does not in and of itself present any ethical difficulties.

The fact that the form of organization used to practice law continues as an entity, uninterrupted by the death, incompetency, bankruptcy, etc., of its members, does not in and of itself present any ethical problems. Continuity of life necessarily involves transferability of interests. Thus continuity of life must be attained by such restrictions on transferability of interests as may be essential to avoid ethical objections. If continuity of life may involve continuity of name, it must be kept in mind that Canon 33 places certain restraints on the selection and use of a firm name. Furthermore, the previously expressed views of this Committee on the use of the name of a deceased person in a firm name are applicable.

The practice of law under a form of organization that permitted the transfer of a lawyer's interest in the organization to a non-lawyer, so as to give him a permanent beneficial and voting interest in a going and continuing organization engaged in the practice of law, would *not* be consistent with the present ethical restraints imposed on the members of the legal profession by the Canons of Ethics.

Canon 33 prohibits the formation of a partnership for the practice of law between lawyers and non-lawyers. This prohibition would likewise apply to the practice of law in any other form. Permanent beneficial and voting rights in the organization set up to practice law, whatever its form, must be restricted to lawyers while the organization is engaged in the practice of law.

Canon 34 prohibits any division of fees for legal services with a non-lawyer. If non-lawyers could acquire permanent beneficial interests in a going organization that was practicing law, it would inevitably lead to the division of fees with them.

An organization practicing law may employ many non-lawyers. The source of funds to pay them for their services will be fees for legal services rendered. The use of the fees to pay agreed salaries to non-lawyer employees, of course, is not a violation of Canon 34. However, if the salary of a non-lawyer employee is to be based on a percentage of the net profits, a division of fees for legal services would be involved and Canon 34 would prohibit it. Thus, if a professional association or professional corporation is organized to practice law and it is approved as a corporation for federal income tax purposes, it would not be ethically proper for it to have a profit-sharing plan if non-lawyers were included as beneficiaries of the plan.

The statement in formal Opinion 283 that "the sharing of employees, non-members of the Bar such as clerks and stenographers, of the fees paid into the trust would be a clear violation of Canon 34" does not prohibit the pay-

ment of regular compensation to such persons, either presently or on a deferred basis, out of fees collected for legal services.

If the professional association or professional corporation organized to practice law permits the transfer of permanent beneficial and voting interests to non-lawyers, Canon 35 would be violated. It would be an organization that would countenance the intervention of laymen between the lawyer and the client. Mere membership by a lawyer in an organization that would tolerate this is a violation of Canon 35 even though at the moment there are no laymen who own any permanent beneficial and voting interests.

Canons 31, 37 and 47 would also be violated by a lawyer who became a member of an organization engaged in the practice of law that permitted permanent beneficial and voting interests to be transferred to non-lawyers. The lawyer-member of such an organization would have put himself in the position to accept direction from non-lawyers as to what he should do for a client (a violation of Canon 31), the confidences he elicited from clients might not be preserved (a violation of Canon 37), and he would have undertaken to assist a lay agency, personal or corporate, in the practice of law (a violation of Canon 47).

Is the violation of the Canons which flows from a lawyer accepting membership in an organization formed for the practice of law, that permits the transfer of permanent beneficial interests to non-lawyers, cured if the original members must be lawyers and the lawyer-members have the right of first refusal in connection with the transfer of any interest? Formal Opinion 283 held that an organization of lawyers for the practice of law which contemplated transferable shares was unethical even though other lawyer-members had a first option to purchase a member's share. To avoid a violation of the Canons there must be a requirement that a member's transferable interest not fall into the hands of a layman on a permanent beneficial and voting basis.

When lawyers die their property interests must pass to someone. The enforcement of creditor's claims against lawyers leads to the transfer of their property interests. Incompetency of lawyers calls for the administration of their holdings by a conservator or guardian. In each of these instances, and in others of a related kind, a non-lawyer may take over the control of the lawyer's property interests. If the professional association or professional corporation recognizes the transferability of a lawyer-member's interest to persons other than lawyers only for a limited purpose of the administration of the lawyer's property holdings on death, incompetency, bankruptcy, etc., and requires that in a limited period of time his interest must be transferred to a lawyer or lawyers, no violation of the Canons of Ethics is present because of the presence of this limited transferability, provided non-lawyers who acquire an interest under these limited circumstances are not entitled to access to the confidences of any client and have no voice in the management of the association or corporation and cannot participate in any distributions based on fees earned during such limited period of time.

ETHICS MATERIALS—LAWYERS

The question initially presented in this Opinion—Can lawyers carry on the practice of law as a professional association or professional corporation, which has the characteristics of limited liability, centralized management, continuity of life, and transferability of interests, without being in violation of one or more of the Canons of Ethics is answered in the affirmative provided appropriately safeguards are observed. It is the substance of the arrangement and not the form which will be controlling in determining whether the ethical restraints imposed on the legal profession have been violated.

All members of the Committee (Messrs. Armstrong, Casner, Johnson, Joiner, McCown, Pettengill, Shepherd and Smith) concur in this Opinion.

APPENDIX D

INCORPORATION BY PROFESSIONALS IN CANADA[1]

This appendix presents in schematic form the provisions in each province governing incorporation by accountants, architects, dentists, doctors, engineers, land surveyors, lawyers and pharmacists. For each profession the tables show:

(i) whether or not members of the profession may incorporate; and

(ii) if they may incorporate, whether:

(a) the liability of the shareholders is limited or unlimited;

(b) the beneficial ownership of shares in the corporation is restricted; and

(c) the directors and/or officers of the corporation must possess professional qualifications.

The information presented in the tables is based primarily on a review of the statutes governing each profession and the relevant provincial corporations legislation. In numerous cases there is no explicit provision either permitting or prohibiting incorporation by members of a particular profession. As a result, in some cases the question of incorporation must be answered by inference from the statutory provisions regarding membership and/or practice of the profession.

In a number of cases, however, practice in a particular profession or province appears to be at variance with the natural inference that would be drawn from the governing statute. Therefore, letters have been sent to confirm the practices in each province and these tables should be treated as tentative until replies have been received.

---

1. This appendix was prepared by James Douglas, a student at the Faculty of Law, University of Toronto.

ACCOUNTANTS

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirement
B.C.	--No, by inference s. 18(1) The Chartered Accountants Act R.S.B.C. 1960, c. 51 and the by-laws of the provincial association	--	--	--
Alta.	--Yes, s. 15(3.1) The Companies Act R.S.A. 1970, c. 60 as amended (1975)	--unlimited, s. 55(1) and (2) The Chartered Accountants Act R.S.A. 1970, c. 42 as amended (1975)	--accountants only, s. 53 (3)(f) The Chartered Accountants Act R.S.A. 1970, c. 42 as amended (1975)	--directors must be accountants, s. 53(3)(f) The Chartered Accountants Act R.S.A. 1970, c. 42 as amended (1975)
Sask.	--No, by-laws of provincial association	--	--	--
Man.	--No, s. 14 The Chartered Accountants Act R.S.M. 1970, c. C-70.	--	--	--
Ont.	--No, s. 3(3) O.B.C.A. R.S.C. 1970, c. 53 and s. 25(1) The Public Accountancy Act R.S.O. 1970, c. 373.	--	--	--

Accountants (continued)

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirement
Que.	--No, by inference s. 1(c), 17 and 20 The Chartered Accountants Act S.Q. 1973, c. 64	--	--	--
N.S.	--No, s. 21 The Public Accountants Act R.S.N.S. 1967, c. 245	--	--	--
N.B.	--No	--	--	--
P.E.I.	--No, s. 15(2) The Public Accounting and Auditing Act R.S.P.E.I. 1974, c. P-27.	--	--	--
Nfld.	--Yes, s. 6 The Companies Act R.S.N. 1970, c. 54 and s. 23 The Chartered Accountants Act R.S.N. 1970, c. 34	--unlimited, s. 23 The Chartered Accountants Act R.S.N. 1970, c. 34	--	--

ARCHITECTS

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
B.C.	--No, s. 32 and 56(1) The Architectural Profession Act R.S.B.C. 1960, c. 16	--	--	--
Alta.	--Yes, s. 15(1) The Companies Act R.S.A. 1970, c. 60 as amended and s. 3(1) The Architects Act R.S.A. 1970, c. 22	--limited, s. 15(1)(a) and 16(c) The Companies Act R.S.A. 1970, c. 60.	--architects only, s. 3 (1)(c) The Architects Act R.S.A. 1970, c. 22	--only architects, s. 3(1)(c) The Architect Act R.S.A. 1970, c. 22
Sask.	--Yes, s. 36(1) The Architects Act S.S. 1968, c. 6	--limited, s. 43(1) S.B.C.A. S.S. 1977, c. 10 c. 10	--75% voting shares must be held by architects (by-laws of the S.A.A.)	--majority of directors must be architects (by-laws of the S.A.A.)
Man.	--No, s. 16 The Architects Act R.S.M. 1970, c. A-130	--	--	--
Ont.	--No, s. 3(3) O.B.C.A. R.S.O. 1970, C. 53 and s. 5(2) The Architects Act R.S.O. 1970, c. 25	--	--	--

Architects (continued)

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
Que.	--No, s. 1(c), 10, 14 and 15 The Architects Act S.Q. 1973 c. 59 (by inference)	--	--	--
N.S.	--Yes, s. 21 The Architects Act S.N.S. 1968, c. 3	--limited, s. 8 The Companies Act R.S.N.S. 1967, c. 42	--majority of voting shares must be held by architects, s. 21(b) The Architects Act S.N.S. 1968 c. 3	--majority of directors must be architects; one officer an architect and work supervised by architect, s. 21(b),(c) and (d) The Architects Act S.N.S. 1968, c. 3 as amended.
N.B.	--Yes, s. 36 The N.B. Architects Act S.N.B. 1970, c. 52	--limited, s. 49(1) and (2) The Companies Act R.S.N.B. 1973, c. C-13.	--100% all classes must be held by architects, s. 36(d) The N.B. Architects Act S.N.B. 1970, c. 52 and 51% all classes must be held by directors s. 36(c) The N.B. Architects Act S.N.B. 1970, c. 52.	--2/3 directors architects s. 36(c) The N.B. Architects Act S.N.B. 1970, c. 52.
P.E.I.	--No, s. 10, 18, 19(1) and (2), 41 The Architects Act R.S.P.E.I. 1974, c. A-16 (by inference)	--	--	--
Nfld.	--No, s. 34 The Nfld Architects Act R.S.N 1970, c. 253.	--	--	--

DENTISTS

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
B.C.	--No, s. 70 The Dentistry Act R.S.B.C. 1960, c. 99 as amended	--	--	--
Alta.	--Yes, s. 15(3.1) The Companies Act R.S.A. 1970, c. 60 as amended (1975)	--unlimited, s. 72(1) and (2) The Dental Association Act R.S.A. 1970, c. 90 as amended (1975)	only dentists, s. 70 (3)(f) The Dental Association Act R.S.A. 1970, c. 90 as amended (1975)	--director(s) must be dentist(s) s. 70(3)(f) The Dental Association Act R.S.A. 1970, c. 90 as amended (1975)
Sask.	--No, s. 47(1) The Dental Profession Act R.S.A. 1965, c. 311	--	--	--
Man.	--No, s. 20(1),(2) or (3) The Dental Association Act S.M. 1971, c. 44	--	--	--
Ont.	--No, s. 3(3) O.B.C.A. R.S.O. 1970, c. 53	--	--	--

Dentists (continued)

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
Que.	--No, s. 1(c), 29, 32, 38 The Dental Act S.Q. 1973, c. 49 (by inference)	--	--	--
N.S.	No, s. 26(1) The Dental Act R.S.N.S. 1967, c. 75	--	--	--
N.B.	--No, s. 8(14) and 14 The N.B. Dental Act S.N.B. 1976, c. 67 (by inference)	--	--	--
P.E.I.	--No, s. 8(1), 11(1), 15(1)(a) The Dental Professions Act R.S.P.E.I. 1974, c. D-4 (by inference)	--	--	--
Nfld.	--No, s. 26 The Dental Act R.S.N. 1970, c. 77 (be inference)	--	--	--

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
B.C.	--No, s. 34,71 and 75(a) The Medical Act R.S.B.C. 1960, c. 239 as amended (by inference)	--	--	--
Alta.	--Yes, s. 15(3.1) The Companies Act R.S.A. 1970, c. 60 as amended (1975)	--unlimited, s. 89(1) and (2) The Medical Profession Act S.A. 1975, c. 26 as amended 1975	--doctors only, s. 87 (1)(f) The Medical Profession Act S.A. 1975, c. 26 as amended (1975)	--directors must be doctor(s), s. 87(1)(f) The Medical Profession Act S.A. 1975, c. 26 as amended (1975)
Sask.	--No, s. 28, 29 and 54 The Medical Profession Act R.S.S. 1965, c. 303 as amended (by inference)	--	--	--
Man.	--No, s. 18 The Medical Act R.S.M. 1970, c. M-90	--	--	--
Ont.	--No, s. 3(3) O.B.C.A. R.S.O. 1970, c. 53.	--	--	--

Doctors (continued)

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
Que.	No, s. 1(c), 31, 35, 41 The Medical Act S.Q. 1973, c. 46 (by inference)	--	--	--
N.S.	--No, s. 13(1)-(3) and 40(1) The Medical Act S.N.S. 1969, c. 15 (by inference)	--	--	--
N.B.	--No, s. 15 and 24(1) The Medical Act S.N.B. 1958, c. 74 (by inference)	--	--	--
P.E.I.	--No, s. 27 and 43 The Medical Act R.S.P.E.I. 1974, c. M-8 (by inference)	--	--	--
Nfld.	--No, s. 22 and 30 The Medical Act S.N. 1974, c. 120 (by inference)	--	--	--

	Availability Corporation form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
B.C.	--Yes, s.3(6) The Engineering Profession Act R.S.B.C. 1960, c.128	--limited, s.53(1) and (2) The Companies Act S.B.C. 1973 c.18	--none	--supervision by engineer, s.3(6) The Engineering Profession Act R.S.B.C 1960, c. 128
Alta.	--Yes, s.15(1) The Companies Act R.S.A. 1970, c.60 and s.21(1) The Engineering and Related Professions Act R.S.A. 1970 1970, c.124	--limited s.15(1)(a) and 16(c) The Companies Act R.S.A. 1970, c.60	--none	--supervision by engineer, s.21(1)(b) The Engineering and Related Professions Act. R.S.A. 1970, c.124.
Sask.	--Yes, s.7(2) The Engineering Profession Act R.S.S. 1965, c.309 as amended	--limited, s.43(1) The Business Corporations Act S.S. 1977, c.10	--majority must be engineers s.7(2)(b) The Engineering Profession Act R.S.S. 1965, c.309 as amended	--majority of directors must be engineers and supervision by engineer s.7(2)(b) and 7(2)(c) The Engineering Profession Act, R.S.S. 1965, c. 309 as amended
Man.	--No, s. 15 The Engineering Profession Act R.S.M. 1970, c. E-120	--	--	--
Ont.	--Yes, s. 3(3) O.B.C.A. R.S.O. 1970, c. 53 and s. 20(2) The Professional Engineers Act R.S.O. 1970, c. 366	--limited, s. 104 O.B.C.A. R.S.O. 1970, c. 53	--	--

Engineers (continued)

	Availability of Corporate form	Libaility of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
Que.	--No, s. 1(d), 15 and 27 The Engineers Act R.S.Q. 1964 c. 262 as amended (by inference)	--	--	--
N.S.	--Yes, s.10(2) The Engineering Profession Act R.S.N.S. 1967, c. 90.	--limited, s. 8 The Companies Act R.S.N.S. 1967, c. 42.	--none	--supervision by engineers, s. 10(2) The Engineering Profession Act R.S.N.S. 1967, c.90
N.B.	--Yes, s. 8(3) The Engineering Profession Act S.N.B. 1970, c.55	--limited, s. 49(1) and (2) The Companies Act R.S.N.B. 1973, c. c-13.	--none	--supervision by engineer, s. 8(3) The Engineering Profession Act S.N.B. 1970, c.55
P.E.I.	--Yes, s. 11(2) The Engineering Profession Act R.S.P.E.I. 1974, c. E-6	--limited, s. 57 The Companies Act R.S.P.E.I. 1975, c. C-15.	--none	--supervision by engineer, s. 11(2) The Engineering Profession Act R.S.P.E.I. 1974, c. E-6
Nfld.	--Yes, s.11 The Nfld. Engineering Profession Act R.S.N. 1970, c. 258 as amended.	--limited, s. 6 The Companies Act R.S.N. 1970, c. 54	--none	--member of co. or employee must be engineer, s. 11 The Nfld. Engineering Profession Act R.S.N. 1970, c. 258 as amended

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
B.C.	--No, s. 46, s. 51 (1) and (2) The Land Surveyors Act R.S.B.C. 1960, c. 211 (by inference	--	--	--
Alta.	--No, s. 53(1) and 54 The Land Surveyors Act R.S.A. 1970, c. 197 (by inference)	--	--	--
Sask.	--No, s. 25, 26(1) and (2), 47 The Land Surveyors Act M.S.A. 1965, c. 304 (by inference)	--	--	--
Man.	--No, s. 29 and 55 The Land Surveyors Act R.S.M. 1970, c. 2-60 (by inference)	--	--	--
Ont.	--Yes, s. 3(3) O.B.C.A. R.S.O. 1970, c. 53 and s. 26 (2) The Surveyors Act R.S.O. 1970, c. 452.	--limited, s. 104 O.B.C.A. R.S.O. 1970, c. 53	--majority of each class must be held by surveyors, s. 26(2) (c) The Surveyors Act R.S.O. 1970, c. 452	--director or officer surveyors must supervise work, s. 26(2)(b) The Surveyors Act R.S.O. 1970, c. 452

Land Surveyors (continued)

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
Que.	--No, s. 1(c), 37 41, 42 The Land Surveyors Act S.Q. 1973, c. 61 (by inference)	--	--	--
N.S.	--Yes, s. 19(2) The N.S. Land Surveyors Act S.N.S. 1977, c. 13	--unlimited, s. 22(2) The N.S. Land Surveyors Act S.N.S. 1977, c. 13	--majority of voting shares must be held by surveyors, s. 19(3)(a) The N.S. Land Surveyors Act S.N.S. 1977, c. 13	--one director and one officer most be a surveyor, s.19(3)(b) The N.S. Land Surveyors Act S.N.S. 1977, c. 13
N.B.	--Yes, s. 4(1) The Companies Act R.S.N.B. 1973, c. C-13	--limited, s. 49(1) and (2) The Companies Act R.S.N.B. 1973, c. C-13	--none	--none
P.E.I.	--No, s. 9(1) and 16 The Land Surveyors Act R.S.P.E.I. 1974, c. L-5 (by inference)	--	--	--
Nfld.	--No, s. 17 The Land Surveyors Act R.S.N. 1970, c. 198 (by inference)	--	--	--

	Availability of Corporation form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
B.C.	No, s. 72 The Legal Professions Act, R.S.B.C. 1960, c. 214			
Alta.	Yes, s.13(2) and s.15(3.1) The Companies Act, R.S.A. 1970, c. 60 as amended (1975)	Unlimited, s.115(1) and (2) The Legal Profession Act R.S.A. 1970, c.203 as amended (1975).	Lawyers only, s.113 (3) (f) The Legal Profession Act R.S.A. 1970, c. 203 as amended (1975)	All directors must be members of Law Society s.113(3)(f) The Legal Profession Act, R.S.A. 1970 c.203 as amended (1975)
Sask.	No, s.5(1)-(6) The Legal Profession Act R.S.S. 1965 c. 301 as amended, (by inference)	--	--	--
Man.	No, s. 33, 34 and 48(13) The Law Society Act R.S.M. 1970, c.L-100 (by inference)	--	--	--
Ont.	No, s.3(3) O.B.C.A. R.S.O. 1970, c.53 and (s.28 and 50) The Law Society Act R.S.O. 1970, c. 237.	--	--	--

Lawyers (continued)

	Availability Corporation form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
Que.	No, s.45 and 132 The Bar Act, S.Q. 66/67, c.77 as amended (by inference)	--	--	--
N.S.	No, s.4(1) The Barristers and Solicitors Act, R.S.N.S. 1967, c.18.	--	--	--
N.B.	No, s.4(1)-(7), 14(1) and 15(1) The Barristers Society Act S.N.B. 1973, c.80 (by inference)	--	--	--
P.E.I.	No, s.15 and 19 Law Society and Legal Profession Act R.S.P.E.I. 1974, c.L-5 (by inference)	--	--	--
Nfld.	No, s. 85 The Law Society Act S. Nfld. 1977, c.77 (by inference)	--	--	--

PHARMACISTS

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
B.C.	--Yes, s. 18(1)(h) The Pharmacy Act S.B.C. 1974, c. 62	--limited, s. 53(1) and (3) The Companies Act S.B.C. 1973, c. 18	--none	--majority of directors must be pharmacists and must be managed by a pharmacist, s. 18(1)(h) and 19(2)(b)(i) The Pharmacy Act S.B.C. 1974 c. 62
Alta.	--Yes, s. 15(1) The Companies Act R.S.A. 1970, c. 60 as amended (1975) and s. 40(6) The Pharmaceutical Association Act R.S.A. 1970, c. 274	--limited, s. 15(1)(a) and 16(c) The Companies Act R.S.A. 1970, c. 60 as amended	--none	--must be managed by a pharmcist, s. 40(6)(b) and 41 The Pharmaceutical Assocaition Act R.S.A. 1970, c. 274
Sask.	--Yes, s. 62 and 63 The Pharmacy Act S.S. 1971, c. 37	--limited, s. 43(1) S.B.C.A.	--majority must be owned by Canadian(s) or other British subject(s), s. 62(a) The Pharmacy Act S.S. 1971, c. 37	--majority of directors pharmacists and one of directors manages, s. 62 (b) and (c) The Pharmacy Act S.S. 1971, c. 37
Man.	--Yes, s. 24 The Pharmaceutical Act R.S.M. 1970, c. P-60	--limited, s. 43(1) The Corporations Act S.M. 1976, c. 40	--none	--must be managed by a pharmacist, s.24(5) The Pharmaceutical Act, R.S.M.,1970,c.P-60
Ont.	--Yes, s. 3(3) O.B.C.A. R.S.O. 1970 c. 53 and s. 141 The Health Disciplines Act S.O. 1974, c. 47	--limited, s. 104 O.B.C.A. R.S.O. 1970, c. 53	--majority of all classes of shares must be owned by pharmacists, s. 141(2) The Health Disciplines Act S.O. 1974 c. 47	--majority of directors must be pharmacists, s. 141(1) The Health Disciplines Act S.O. 1974 c. 47

Pharmacists (continued)

	Availability of Corporate form	Liability of Shareholders	Restrictions on Beneficial Ownership of Shares	Director/Officer Requirements
Que	--No, s. 27 The Pharmacy Act S.Q. 1973 c. 51	--	--	--
N.S.	--Yes, s. 8 The Companies Act R.S.N.S. 1967, c. 42	--limited, s. 8 The Companies Act R.S.N.S. 1967, c. 42	--majority of common must be held by pharmacists, s. 24(1) The Pharmacy Act R.S.N.S. 1967, c. 229	--majority of directors must be pharmacists, s. 24(1) The Pharmacy Act R.S.N.S. 1967, c. 229
N.B.	--No, s. 24(1) and (2) The Pharmaceutical Act S.N.B. 1958, c. 77 (by inference)	--	--	--
P.E.I.	--Yes, s. 21(1) The Pharmacy Act R.S.P.E.I. 197 1974, c. P-5	--limited, s. 49(1) and (2) The Companies Act R.S.P.E.I. 1975, c. C-15	--none	--supervision by pharmacist, s. 30 The Pharmacy Act R.S.P.E.I. 1974, c. P-5
Nfld.	--Yes, s. 6 The Companies Act R.S.N. 1970, c 54	--limited, s. 6 The Companies Act R.S.N. 1970 c. 54	--none	--supervision by pharmacist, s.28(1) and 32 The Pharmaceutical Association Act, R.S.N. 1970, c.295

THE TAX IMPLICATIONS OF PERMITTING THE BUSINESS OF A PROFESSION TO BE CARRIED ON THROUGH A CORPORATION IN ONTARIO

A Working Paper prepared by:

Thomas E. McDonnell
Barrister and Solicitor
Toronto, Ontario

for
The Professional Organizations Committee

1978

TABLE OF CONTENTS

INTRODUCTION

The purpose of this paper is to examine the tax implications of allowing professionals to conduct their practices through a corporation in Ontario. The taxes considered are those imposed by the federal Income Tax Act[1] and The Ontario Corporations Tax Act[2] and Income Tax Act.[3]

The analysis is in the form of a comparison of the tax impact on the professional carrying on business through a corporation with one who does not. For purposes of Parts 1 to 4 of this paper it has been assumed that any legislation permitting professionals to incorporate in Ontario would require all shareholders of a professional corporation to be qualified professionals. In Part 5, this assumption is released, and the tax implications of allowing non-professional persons to acquire shares in a professional corporation are considered.

Summary and Conclusions

This paper is divided into five parts. Part 1 is a brief summary of the relevant provisions of the applicable taxing statutes. The general rules applicable to individuals are set out, including the important distinctions between income from a business and income from employment. The taxation of corporations is discussed next. The special rules applicable to Canadian-controlled private corporations are noted, both with respect to active business and investment income. This leads to an examination of the gross-up and credit rules for dividends paid by such corporations and the tax advantages that may be obtained when dividends are paid out of active business income. The

impact of the Ontario corporations tax and paid-up capital tax is then considered.

In Part 2, the special provisions of The Income Tax Act (Canada) relating to deferred income arrangements are reviewed. The position of an unincorporated professional is compared with that of a person able to carry on a similar business in the corporate form.

Part 3 looks at a number of situations in which the right to incorporate would lead to direct tax savings; Part 4 is concerned with a number of considerations that are particular to the medium and large-size firm. Part 5 deals with the tax implications of non-professional share ownership.

Conclusions

(1) Based on 1977 rates and brackets, and assuming a provincial rate for individuals of 44% of the federal tax, there is no advantage to incorporation if net professional income[4] before tax is less than approximately $8,000. (Paragraph 3.01.) Taking into account personal deductions, it may be said that the approximate net income level above which incorporation may provide a tax advantage is about $8,000 of net professional income plus the total deductions available to the individual in computing income and taxable income. In general terms, it is probably fair to say that no real tax advantage is possible until net professional income reaches the $12,000 to $15,000 level. (Paragraph 3.03.)

(2) Assuming net professional income of $50,000 and other income equal to all other available deductions, the maximum tax that may be saved by incorporating is about $4,800 a year. (Paragraph 3.04.)

(3) A professional allowed to operate through a corporation will maximize his deferred income arrangements by establishing a registered retirement savings plan and by causing his corporation to establish a deferred profit sharing plan. This will permit combined corporate-personal deductions of $9,000 per year for contributions to such plans. The maximum deductible contribution for an unincorporated professional is $5,500. (Paragraph 2.07.)

(4) In some circumstances, it may be possible for a professional corporation to establish a registered pension plan for the benefit of its professional employees. (Paragraph 2.02, and paragraph 4.40.) However, in most cases it would appear to be more advantageous to establish a deferred profit sharing plan instead of a registered pension plan. (Paragraph 2.07.)

(5) There is a trade-off between minimizing current taxes through incorporation and maximizing the amount of deductible contributions to deferred income plans. If the incorporated professional wishes to claim the maximum registered retirement savings plan deduction, the current saving in tax on net professional income of $50,000 is reduced from about $4,800 per year to about $2,200. This does, however, still represent a net annual advantage over the position of the unincorporated professional. (Paragraph 3.05.)

(6) The incorporated professional may cause his corporation to employ his spouse to perform non-professional tasks. Any salary paid to the spouse will be deductible for tax purposes, assuming the amount paid is reasonable in the circumstances. This is not the case for unincorporated professionals who employ their spouses in a similar capacity. (Paragraph 3.07.)

(7) In the case of certain kinds of investment income, (notably, interest, rents, and capital gains) there is a small positive advantage available if such income is earned in a corporation. For a shareholder at the top marginal rate, the saving is about 5% of the investment income. (Paragraph 1.14, and Table 7.) This saving is available now to any professional with investment income, since there is no prohibition against transferring such investments to a corporation. Allowing professionals to conduct their practices through a corporation is irrelevant, then, with respect to investment income of this kind.
(8) For medium-and large-size firms, the tax advantages of incorporation may be limited to the more generous deferred income arrangements that are available. Current savings in tax are likely to be small because of the early elimination of the low rate available on up to $750,000 of active business income. (Paragraph 4.02.) In some cases, incorporation could lead to an increase in current taxes rather than a reduction of tax. (Paragraph 4.02, and Table 13.)

PART 1 - SUMMARY OF TAXING PROVISIONS

1.01 For tax purposes, a corporation is regarded as an entity separate from its shareholders. As such, the corporation is taxed separately on its income and the shareholders are only taxable on amounts distributed to them by the corporation. It is assumed here that the existence of the corporation will be recognized for tax purposes.[5] In the discussion that follows, the taxation of individuals is considered separately from that of corporations.

The Taxation of Individuals

1.02 Under The Income Tax Act, individuals are taxed at progressive rates that increase with respect to identified brackets of taxable income.[6] Taxable income within a particular bracket is taxable at the rate specified for that bracket even though there may be income falling into a different bracket that is taxable at a higher (or lower) rate. Thus the 1977 rate on the lowest bracket ($710 or less) is 6%, and does not increase if there is taxable income in excess of $710. In that event, only the excess is taxed at higher rates. The scope of the brackets is subject to an annual indexing factor designed to compensate for inflation.[7] The following table indicates the brackets that apply in 1977,[8] and the applicable rates, taking into account the recent federal-provincial agreement providing for a shift of additional tax points to the provinces.[9]

TABLE 1

1977 FEDERAL INCOME TAX RATES

Taxable Income	Tax
$ 710 or less	6%
In Excess of	
$ 710	$ 43 + 16% on next $ 709
$ 1,419	$ 156 + 17% on next $ 1,419
$ 2,838	$ 397 + 18% on next $ 1,419
$ 4,257	$ 653 + 19% on next $ 2,838
$ 7,095	$ 1,192 + 21% on next $ 2,838
$ 9,933	$ 1,788 + 23% on next $ 2,838
$ 12,771	$ 2,441 + 25% on next $ 2,838
$ 15,609	$ 3,150 + 28% on next $ 4,257
$ 19,866	$ 4,342 + 32% on next $14,190
$ 34,056	$ 8,882 + 36% on next $21,285
$ 55,341	$16,545 + 39% on next $29,799
$ 85,140	$28,167 + 43% on remainder

Source: Canada Tax Service, p. 117-118

1.03 Individuals are taxable with respect to taxable income earned or received during the calendar year. Taxable income may be derived from various sources, the traditional ones being employment, business and property. Several features of income from these sources are important in this context. Employment income is taxable in the calendar year during which it is received and income tax is withheld at source by the employer at the time of payment. Business income is computed by reference to a taxation year, which need not coincide with the calendar year. An individual earning income from a business is taxable in any calendar year with respect to the income of the business for the taxation year ending in that calendar year. For example, if individual A carries on a business which has a January 31st year end, in computing income for 1977, A will include only the profits of the business for the taxation year ending January 31, 1977. The profits earned in the period February 1 to December 31, 1977 will fall into the taxation year ending January 31, 1978, and so will not be taxable to A until 1978.

1.04 Individual taxpayers carrying on a business are not subject to tax deductions at source. Instead, they are required to make quarterly installment payments on account of their income tax liability for the year.

1.05 The significant differences between employment income and income from a business are, therefore, the fact that employment income is taxed on a calendar year basis and income tax is deducted at source, while in the case of business income, the appropriate period is the taxation year, not the calendar year, and tax installments are due quarterly.

1.06 The conduct of a profession is regarded as a business for income tax purposes,[10] so that a person carrying on a profession earns income from a business. Persons may engage in a profession as an employee of the person carrying on the profession, in which event their income is from employment, not a business (for example, a lawyer employed as an associate by a law firm, a nurse on staff at a hospital, a chartered accountant working full-time for a corporation, and so on). If professionals are allowed to incorporate, their corporations will earn income from a business, while the professionals will earn income from employment with their professional corporation.

1.07 In addition to the federal income tax, individuals are taxable by Ontario, under The Income Tax Act. Section 3 of that Act levies a tax at the rate of 44% of the federal tax. Since 1972, the federal rate schedule has, by agreement with the provinces, been set with a standard rate of provincial tax in mind. Thus for an individual resident in Ontario the computation of income tax is a two stage process: the federal tax is computed first, then the provincial tax is determined by applying the provincial rate against the amount of federal tax.

The Taxation of Corporations

1.08 The federal scheme for taxing corporations is complicated by the fact that it is designed to relieve somewhat the double taxation effects that flow from taxing the corporation on its income and then taxing the shareholders again on amounts distributed to them by the corporation. This is achieved by allowing the shareholder a tax credit with respect to taxable dividends received from taxable Canadian corporations.[11] Depending on the circumstances, the amount of the

credit may just equal the tax payable on the dividend, or may be greater or lesser than that amount. In general terms, however, the credit will be slightly greater than the tax if the dividends are paid out of the investment income of the corporation[12] and also will be greater than the tax if the source of the dividend is active business income qualifying for the reduced rate applicable to Canadian-controlled private corporations.[13]

1.09 The taxation of corporations depends on two factors: the status of the corporation (public,[14] private[15] or Canadian-controlled private[16]) and the source of its income (active business,[17] investment[18] or non-active business[19]). For purposes of this paper, it can be assumed that a professional corporation carrying on a profession in Ontario will be a Canadian-controlled private corporation and that its income from the profession will qualify as active business income. It is not unreasonable to assume that the corporation may also earn investment income or non-active business income from time to time.

1.10 All corporations resident in Canada are taxable at an initial rate of 46%,[20] regardless of status. Unlike the tax rates applicable to individuals, this is a flat rate and applies on every dollar of taxable income. As an incentive for small businesses, Canadian-controlled private corporations ("CCPC's") are entitled to a tax reduction of twenty-one points of the tax otherwise payable, on up to $150,000 of active business income ("ABI") in any year.[21] There is a cumulative limit of $750,000 above which the reduced rate does not apply, unless the corporation has paid taxable dividends out of its accumulated active business profits.[22] ABI in excess of $150,000 in any one year, or in excess of the $750,000 cumulative limit at any time, is taxed at 46%.

1.11 Investment income or non-active business income is also taxed at 46% but does not qualify for the small business reduction. Instead, the corporation becomes entitled to a refund of a percentage of the tax, payable at a prescribed rate when the corporation pays taxable dividends to its shareholders out of the investment or non-active business income.[23] The refundable tax is approximately one-sixth of investment income such as interest and rentals, the taxable half of realized capital gains and of any non-active business income.[24] It also includes the full amount of any Part IV tax payable by the corporation on certain taxable dividends received on portfolio investments in other private corporations.[25] The refundable tax is recoverable by the corporation at the rate of $1.00 of tax for every $4.00 of taxable dividends paid. The following tables illustrate the taxes payable by a CCPC on various sources of income.

TABLE 2 - TAX ON ACTIVE BUSINESS INCOME

ABI In Year	Basic Rate	Reduced Rate	Tax	Refundable Tax
150,000[a]	46%	25%	37,500	Nil
200,000[a]				
150,000	46%	25%	37,500	Nil
50,000	46%	Nil	23,000	Nil

Notes:

[a] Assumes that the full $150,000 qualifies for the low rate.

TABLE 3 - TAX ON INVESTMENT & NON-ACTIVE BUSINESS INCOME

Type of Income	Basic Rate	Reduced Rate	Tax	Refundable Tax
$1,000 (interest or rent)	46%	Nil	460	166.65
2,000 (capital gain) [a]	46%	Nil	460	166.65
5,000 (dividend)[b]	25%[c]	Nil	1,250	1,250.00

Notes:

[a] One-half the capital gain is taxable.

[b] Assumes the dividend is subject to the Part IV tax.

[c] Under Part IV, the rate is 25%, not 46%.

1.12 The taxation of dividends paid by CCPC's varies depending on whether the shareholder is an individual or a corporation. It may be assumed that any legislation permitting the incorporation of professional practices will provide that only qualified individuals may become shareholders of such corporations, so that the general rules relating to the taxation of corporate shareholders may be ignored here. In the case of individual shareholders, the underlying theory of the Act is that, with respect to all income except ABI which does not qualify for the reduced rate, the combined corporate-shareholder tax should not exceed the tax that would have been paid if the shareholder had earned that income directly. Putting it another way, the Act is premised on the assumption that the combined tax on qualifying ABI, investment and non-active business income earned by a corporation and immediately thereafter distributed to its shareholders, ought not to be greater than the tax the shareholder would have paid had he earned the income personally, not through a corporation.

1.13 In the case of dividends paid out of qualifying ABI, this is accomplished through the dividend tax credit, which prior to the 1977 amendments was such that it reduced the shareholder's tax on the dividend by 25%. Thus, as long as the corporate tax did not exceed 25%, the dividend tax credit put the shareholder in the same position after paying tax on the dividend as if he had earned the income directly.[26] These provisions were amended in 1977, as a result of which the credit now offsets approximately thirty-three points of corporate tax. To the extent that the corporate rate is in fact less than this (as it is in the case of qualifying ABI which is taxed at 25% in the corporation), the shareholder will be better off for having carried on his business in a corporation. Or, looking at it in another way, an individual who is permitted to incorporate his business will be in a position of positive advantage vis à vis one who is prevented by provincial law from doing so. This effect is illustrated by the following tables.

TABLE 4 - OPERATION OF GROSS-UP AND CREDIT ON DIVIDENDS

Taxpayer's combined federal and provincial marginal rate	40%		50%		60%	
	1977	1978	1977	1978	1977	1978
Dividend	$100	$100	$100	$100	$100	$100
Gross-up[a]	33	50	33	50	33	50
Taxable dividend	133	150	133	150	133	150
Income tax before credit	53	60	66	75	80	90
Dividend tax credit[b]	36	54	36	54	36	54
Income tax payable	17	6	30	21	44	36
After-tax return	$ 83	$ 94	$ 70	$ 79	$ 56	$ 64

Notes:

[a] Prior to the 1977 amendments, paragraph 82(1)(b) provided that in addition to including the amount of the dividend in income, the shareholder also included an additional amount equal to one-third of the dividend. The additional amount is referred to as the gross-up.

.../cont'd.

(Table 4 cont'd.)

[b] This is a simplified calculation of the credit mechanism and reflects the combined effect of the federal and provincial tax. Technically, the federal credit is 75% of the gross-up (80% in 1976) and the provincial credit is reflected in the fact that the provincial tax is computed as a percentage of the federal tax (44% in 1977; 30.5% in 1976.) As this table demonstrates, the actual amount of the credit after applying these rules is in excess of the gross-up.

TABLE 5 - COMBINED CORPORATE-SHAREHOLDER TAX ON ABI

Assume corporation X earns $100 of qualifying ABI.

Basic corporate tax @ 46%		$46	
Small business credit: 21% x $100		21	
		$25	25
Available for distribution		$75	
Assume X pays a dividend of $75 to shareholder A, taxable at a 50% rate (federal-provincial combined)			
dividend	$75		
gross-up	37.50		
taxable amount	112.50		
tax before credit	56.25		
dividend tax credit	40.50		
tax payable	15.75		15.75
Combined corporate-shareholder tax			$40.75
Tax payable by A if $100 of ABI earned directly: 50% x $100.			50.00
Tax saved by using corporation			$ 9.25

1.14 A somewhat different procedure applies with respect to distributions out of investment income and non-active business income.[27] As noted in paragraph 1.11 and Table 3, tax is payable by the corporation at the basic rate on income of this type, but the corporation is entitled to a refund of a part of the tax so paid at the time taxable dividends are paid. In theory, the refundable tax is designed to

reduce the effective corporate rate to an amount which is completely offset by the dividend tax credit allowed the shareholder. In this way, the shareholder is put in the same position after tax as he would have been if he had received the income directly. The theory works at a basic corporate rate of 50%. However, since the basic rate is 46%, there is a small positive advantage available through holding income producing investments in a corporation. This effect is illustrated in the following tables. Table 6 illustrates the effect of earning $100 of interest where the corporate rate is taken at 50% and it is assumed that the shareholder is taxable at a combined federal-provincial rate of 60%. Table 7 is prepared on the basis of a 46% rate and shows a tax saving of $5.21.

TABLE 6

(a) Corporate tax on $100 of investment income of		100.00
(assume a 50% rate)	50.00	
Refundable dividend tax[a]		
2/3 x 25% x 100	16.65	
Net corporate tax		33.35
Available for dividend		66.65
(b) Shareholder tax:		
dividend	66.65	
gross-up	33.33	
taxable amount	99.98	
tax (60%)	59.98	
credit	33.33[b]	
tax payable	26.65	

.../cont'd.

(Table 6 cont'd.)

(c) Combined corporate and shareholder tax:		
(a) corporate	33.35	
(b) shareholder	26.65	60.00
(d) Tax payable by individual if income earned directly		60.00

Notes:

[a] Subsection 129(3), as amended by Bill C-56, clause 58(3).

[b] This is the theoretically correct amount. In fact, the credit is slightly larger because of the interrelationship of the federal and provincial tax.

TABLE 7

(a) Corporate tax on $100 of investment income of		100.00
(assume a 46% rate)	46.00	
Refundable dividend tax 2/3 x 25% x 100	16.65	
Net corporate tax		29.35
Available for dividend		70.65
(b) Shareholder tax:		
dividend	70.65	
gross-up	35.33	
taxable amount	105.98	
tax (60%)	63.58	
credit	38.14	
tax payable	25.44	
(c) Combined corporate and shareholder tax:		
(a) corporate	29.35	
(b) shareholder	25.44	54.79

.../cont'd.

(Table 7 cont'd.)

(d) Tax payable by individual if income earned directly	60.00
(e) Tax saving by interposing corporation[a]	$5.21

Notes:

[a] This is an absolute saving on the assumption that the corporation immediately distributes the investment income after paying the appropriate corporate tax. A further saving is possible if the corporation postpones distribution until a future date. This will be so in any case in which the net shareholder's tax on a dividend is higher than the corporate rate.

Ontario Corporations Tax

1.15 The foregoing examples do not take into account the provincial tax on corporate income. Under The Corporations Tax Act,[28] corporations are taxable at the rate of 12% on the taxable income allocable to a permanent establishment in Ontario. This tax is in addition to the tax on income imposed by the federal Act, but there is a credit of 10% of taxable income (computed under the federal rules) allowed as a deduction from federal tax. Ontario allows a reduction in its rate from 12% to 9% for income which qualifies for the 25% rate under the federal Act. The combined federal-provincial tax on qualifying active business income is therefore 24% (basic federal rate of 25%, less credit of 10%, plus provincial tax at 9%). Non-qualifying active business income, investment income and non-active business income is taxable at a combined rate of 48% (46% less credit of 10%, plus 12%).

Ontario Paid-up Capital Tax

1.16 Ontario also levies a tax on paid-up capital.[29] Paid-up capital for purposes of the tax is defined to include retained earnings,

any capital or other surplus accounts, reserves, loans to the corporation by shareholders or any other corporation, and secured debt.[30] The tax is levied at the rate of 3/10 of 1% of the taxable paid-up capital.[31] The tax on paid-up capital is not likely to be a significant factor in the taxation of professional corporations, except for large firms with substantial borrowings to finance work in progress and receivables.

PART 2 - THE PROFESSIONAL CORPORATION AND DEFERRED INCOME ARRANGEMENTS

Introduction

2.01 The federal and provincial Acts each make provision for certain deferred income arrangements. For the purposes of this paper, the significant plans are Registered Pension Plans ("RPP"), Deferred Profit Sharing Plans ("DPSP") and Registered Retirement Savings Plans ("RRSP"). In each case, contributions to the plan are tax deductible within specified limits, the plan is not taxable on accumulating income, and the member or beneficiary is only taxable on amounts paid to him out of the plan, usually on retirement.

Registered Pension Plans

2.02 An RPP is a pension plan which has been accepted by the Minister of National Revenue for registration.[32] There are no statutory rules governing registration, but a number of administrative guidelines have been published by the Minister in Information Circular 72-13R4 indicating the conditions that must be met before a plan will be accepted for registration. Two of those conditions are important here. First, the plan must be for employees. As such, self-employed professionals do not qualify and may not establish a pension plan for their own benefit. On the other hand, professionals employed by a professional corporation would qualify as employees and, subject to the second point, a pension plan could be established for their benefit by the corporation. Second, the Minister will not accept a plan for registration if it is primarily for the benefit of what are described in the Circular as significant shareholders. These are defined to be persons (or their relatives) who own 10% or more of the outstanding voting shares of the

corporation. Thus, small professional corporations would not be able to establish registered plans.

2.03 An employer is permitted to deduct amounts contributed in respect of both current and past service with the corporation. For practical purposes, the past service provisions will not apply to most professional corporations because of the administrative rules relating to eligible pension service.[33] Contributions for current service are generally limited to a maximum of $3,500 per employee. If the plan so provides, the employees may also make deductible contributions for current service, up to an amount of $3,500 per year.

Deferred Profit Sharing Plans

2.04 Under a DPSP, an employer may deduct up to $3,500, less the amount of any current service contribution made to an RPP. There is a further limitation that the deductible amount cannot exceed 20% of the salary or wages paid in the year to the employee. (The maximum contribution could therefore be made only for employees earning salary or wages of $17,500 or more). Employees may not make deductible contributions to a DPSP.

2.05 Unlike RPP's, there are statutory conditions for registering a DPSP. There is no provision similar to the significant shareholder limitation, so that any professional corporation would be entitled to establish a DPSP for the benefit of its employees.

Registered Retirement Savings Plans

2.06 Individuals may make deductible contributions to an RRSP, not exceeding $5,500. There are a number of factors which limit the amount

deductible. It may not, in any event, exceed 20% of earned income, a limit which affects all employees earning less than $27,500 in the year. If the employee is a member of an RPP, his deductible limit cannot exceed $3,500, even if he makes no contribution to the RPP. If the employee has contributed to an RPP, the $3,500 limit is reduced by the amount of such contributions.[34] The deductible limit is not affected by the amount of any contribution by the employer to a DPSP on the employees behalf.

Summary

2.07 Self-employed professionals are limited to the use of an RRSP to accumulate funds for retirement on a tax deductible basis. The maximum annual contribution that may be deducted is $5,500. On the other hand, employees who are members of RPP may accumulate a maximum of $7,000 per year on a tax-deductible basis, taking both employer and employee contributions into account. Alternatively, the deductible amount could be increased, in effect, to $9,000, by combining a DPSP established by the employer ($3,500 limit) with an RRSP maintained by the employee ($5,500 limit). If professionals were permitted to incorporate there would, therefore, be a significant potential advantage with respect to the deferred income arrangements now available.

PART 3 - SOME EXAMPLES OF POTENTIAL TAX ADVANTAGES OF INCORPORATION

3.01 Whether or not incorporation will result in a tax saving depends on the level of current income, the extent to which the professional is able to leave a percentage of current income in the practice and assumptions regarding deferred income arrangements. Looking only at current income, it can be said that incorporation is not advantageous in any case in which the tax payable by the professional is equal to or less than the combined corporate-shareholder tax payable by a corporation on an equivalent amount of income. In the case of qualifying active business income, the break-even point is about $8,000, ignoring personal deductions, the federal tax credit, and the Ontario paid-up capital tax, as illustrated by the following table.

TABLE 8 - EFFECT OF INCORPORATION, TAXABLE INCOME OF $7095 (qualifying ABI)

Tax payable by corporation:			
Federal (after provincial credit)		15%	
Provincial		9%	
		24% x 7095 =	$1702
Tax payable by individual:			
Federal	$1192		
Provincial	524		$1716

3.02 Table 8 is misleading in that it does not take into account the tax consequences of the corporation distributing the $5,393 remaining after payment of corporate tax. The consequences depend on whether the distribution takes the form of a dividend or salary. If

distributed as a dividend, no additional tax will be payable by the shareholder because of the dividend tax credit; the combined corporate-shareholder tax will remain at 24% of the taxable income. If a salary of $5,393 is paid, $4,257 of it will bear tax of $940.30 and the remaining $1,136, a tax of $310.40, for a total additional tax of $1,250.70. In these circumstances, it would make sense to cause the corporation to distribute the full amount of $7,095 as salary. This would "save" the corporate tax at 24% and would put the shareholder in the same position he would have been in if he had earned the income directly.

3.03 The figures in Table 8 can be adjusted somewhat to take into account the personal deductions of the individual shareholder/proprietor. For example, if it is assumed that the individual supports a wife and two children under 16, personal deductions for 1977 will be $5,120. As a proprietor, the individual could earn income of $12,215 and still be taxable at about the 24% rate on taxable income of $7,095. The income figure will be higher if the individual qualifies for other deductions and if the federal tax reduction[35] is taken into account. Combined corporate-shareholder tax on $12,215 earned by the corporation with the after corporate tax amount distributed as a dividend will remain at 24%, since the dividend tax credit will offset any tax otherwise payable by the shareholder on the dividend. Thus, based on 1977 federal brackets and rates, and assuming a provincial personal income tax computed at 44% of the federal tax, it may be said that the approximate income level above which incorporation may provide a tax advantage is about $8,000 of net professional income plus the total deductions available to the individual in computing income[36] and taxable income.[37] If the effect of

the federal tax reduction is taken into account we may generalize and say that an advantage may be obtained somewhere in the 12,000 to 15,000 net income level.

3.04 If costs of incorporation and the minimum provincial paid-up capital tax ($50) are taken into account, the level of income below which incorporation is advantageous is probably several thousand dollars higher. However, at substantial levels of net professional income, the amount of tax that may be saved on a current basis is appreciable. For example, if net professional income is $50,000 and it is assumed that the professional has other income equal to his personal deductions, a tax saving of about $4,800 is possible by incorporating, if all the after tax corporate income is distributed as a dividend.

TABLE 9 - EFFECT OF INCORPORATION, TAXABLE INCOME OF $50,000 (qualifying ABI)

(1)	Tax payable by corporation:			
	federal	15%		
	provincial	9%		
		24% x 50,000		$12,000.
	Tax payable by shareholder on dividend of $38,000:			
	dividend	38,000		
	gross-up	19,000		
	taxable amount	$57,000		
	Federal tax	17,192		
	Federal credit	14,250	2,942	
	Provincial tax		1,294.50	
	Total		$4,236.50	4,236.50
	Combined corporate-shareholder			$16,236.50
(2)	Tax payable by individual:			
	Federal tax		14,621.84	
	Provincial tax		6,433.60	21,055.44
	Tax saved through incorporation			$4,818.94

3.05 Table 9 ignores the possibility that the professional may want to establish an RRSP and/or a DPSP. If the professional practice is incorporated, the corporation will have to pay some amount of salary in order to qualify for DPSP deductions and to enable the professional to contribute to an RRSP. To obtain the maximum deduction for a DPSP, a salary of $17,500 has to be paid; for a maximum RRSP deduction, the amount of $27,500. If it is assumed first that the professional corporation pays a salary of $27,500 and that the individual makes an RRSP contribution of $5,500 the immediate tax saving is reduced to about $2,200. This comes about because of the net increase in tax payable on the salary of $27,500 by the individual when compared with the tax otherwise payable on an equivalent amount of dividend.

TABLE 10 - EFFECT OF INCORPORATION, TAXABLE INCOME OF $50,000 (qualifying ABI), RRSP CONTRIBUTION OF $5,500

(1) Tax payable by corporation:				
net income		50,000		
salary		(27,500)		
taxable income		22,500		
Federal tax 25%				
Provincial tax 9%				
24% x 22,500				$5,400
Available for dividend, (22,500-5,400)		$17,100		
Tax payable by shareholder on salary of 27,500 and dividend of $17,100:				
salary	27,500			
dividend	17,100			
gross-up	8,550			
	53,150			
RRSP	(5,500)			
taxable income	47,650			
Federal tax	13,775.84			
tax credit	6,412.50		7,363.34	
Provincial tax			3,239.94	
Total			10,603.28	10,603.28
Combined corporate-shareholder				$16,003.28

.../cont'd.

(Table 10 cont'd.)

(2) Tax payable by individual:

net income	50,000	
RRSP	(5,500)	
Taxable income	44,500	
Federal tax	12,641.84	
Provincial tax	5,562.40	18,204.24
Tax saved through incorporation		$2,200.96

3.06 If the professional corporation establishes a DPSP and makes the maximum contribution of $3,500, and if the individual receives a salary of $27,500 and makes an RRSP contribution of $5,500, the indicated tax saving from incorporation becomes $3,673, although there is a reduction in the cash flow available after payment of corporate and shareholder taxes. In this case, however, the individual has the additional benefit of $3,500 accruing to his account in the DPSP. (A more accurate calculation of the tax saving here would take into account the net benefit derived from the tax-free investment income generated on $3,500 while held by the DPSP prior to distribution to the beneficiary.)

TABLE 11 - EFFECT OF INCORPORATION, TAXABLE INCOME OF $50,000 (qualifying ABI), DPSP CONTRIBUTION OF $3,500, RRSP CONTRIBUTION OF $5,500

(1) Tax payable by corporation:

net income		50,000	
salary	27,500		
DPSP	3,500	(31,000)	
taxable income		19,000	
Federal tax	25%		
Provincial tax	9%		
	24% x 19,000		$4,560
Available for dividend (19,000-4,560)		$14,440	

.../cont'd.

(Table 11 cont'd.)

Tax payable by individual on salary of 27,500 and dividend of 14,440:			
salary	27,500		
dividend	14,440		
gross-up	7,220		
	49,160		
RRSP	(5,550)		
Taxable income	43,660		
Federal tax	$12,339.44		
tax credit	5,415	6,924.44	
Provincial tax		3,046.75	
Total		$9,971.19	9,971.19
Combined corporate-shareholder			$14,531.19
(2) Tax payable by individual:			
net income	50,000		
RRSP	(5,500)		
taxable income	44,500		
Federal tax	12,641.84		
Provincial tax	5,562.40		18,204.24
Tax saved through incorporation[a]			3,673.05

Notes:

[a] The saving of $3,673.05 may be somewhat misleading in that the self-employed individual was unable to make a DPSP contribution and therefore has a larger immediate cash flow after tax than the incorporated professional.

Spouse as Employee of Professional Corporation

3.07 It may be assumed that any Ontario legislation permitting the establishment of professional corporations will prohibit persons not qualified as a professional from becoming shareholders in the corporation.[38] This should not prevent the corporation from hiring the spouse of the professional in an appropriate case. As the matter now stands, an individual may not deduct as an expense for tax purposes

a salary paid to his spouse.[39] This limitation does not extend to a salary paid by a corporation controlled by the professional as long as the amount paid is reasonable in the circumstances. Accordingly, where a spouse is able to provide non-professional services to the corporation, there will be further tax advantages available from incorporation. The following table takes the figures developed in Table 10, and assumes that the wife of the professional is employed by the corporation at a salary of $7,000 per annum. This results in a reduction in the combined corporate-shareholder tax of about $1,050.

TABLE 12 - EFFECT OF INCORPORATION, TAXABLE INCOME OF $50,000 (qualifying ABI), DPSP CONTRIBUTION OF $3,500, SALARY TO SPOUSE OF $7,000, RRSP CONTRIBUTION OF $5,500

(1) Tax payable by corporation:

net income		50,000	
salaries:	27,500		
	7,000		
DPSP	3,500	37,500	
taxable income		12,500	
Federal tax	25%		
Provincial tax	9%		
	24% x 12,500		$3,000
Available for dividend (12,500-3,000)	$9,500		

Tax payable by professional and spouse:

(a) Professional

salary	27,500		
dividend	9,500		
gross-up	4,750		
	41,750		
RRSP	(5,500)		
taxable income	$36,250		
Federal tax	9,671.84		
tax credit	3,562.50	6,109.34	
Provincial tax		2,688.10	
Total		8,797.44	$ 8,797.44

.../cont'd.

(Table 12 cont'd.)

(b) Spouse			
salary	$7,000		
Federal tax	$1,174.		
Provincial tax	516.55		
Total		1,690.55	1,690.55
Combined corporate-shareholder tax			13,487.99
Similar amount, Table 3-4			14,531.19
Saving[a]			$1,043.20

Note:

[a]The tax saving is in fact considerably larger if the spouse's personal deductions, standard $100 medical-charitable deduction, $210 employment expense deduction and basic federal tax reduction are taken into account. Also, the employed spouse would qualify for Canada Pension Plan contributions.

PART 4 - SPECIAL CONSIDERATIONS AFFECTING PROFESSIONAL PARTNERSHIPS

4.01 The incorporation of a professional partnership raises considerations beyond those discussed in Parts 1, 2 and 3. They are the early elimination of the low rate for larger corporations, the problem of associated corporations where each professional in the partnership forms his own professional corporation and the possible use of registered pension plans in appropriate cases.

Early Elimination of the Low Rate

4.02 On a current basis, the principal tax benefit from incorporation is the availability of the reduced rate of corporate tax on qualifying active business income ("ABI"). The combined federal-provincial rate is 24% and applies on up to 150,000 of ABI per year, up to a maximum of $750,000. In a simplified way, the over-all maximum is determined as the difference between $750,000 and the aggregate of the corporation's ABI. This running total is referred to as the cumulative deduction account ("CDA").[40] Once the CDA reaches zero, the corporation ceases to qualify for the reduced rate and becomes taxable at a combined federal-provincial rate of 48%. Similarly, any ABI in the year in excess of $150,000 is taxable at the high rate. There is a tax disadvantage to earning ABI in a corporation if it is taxed at the high rate. In that case, the dividend tax credit does not offset all of the tax paid at the corporate level, with the result that the shareholder suffers a measure of double taxation as a consequence. This effect is illustrated by Table 13, which shows that additional tax of about $20,000 is payable on ABI of $250,000 when it is earned in a corporation rather than directly. (The amount of extra tax will vary with the number of shareholders and the extent to which percentage ownership varies.)

TABLE 13 - NON-INTEGRATION WHERE CORPORATE RATE ON ABI EXCEEDS 25%

Assume A,B,C and D are equal shareholders in professional corporation ABCD Ltd., which earns net professional income of $250,000, all of which is distributed to A,B,C and D by way of dividend after payment of corporate tax.

(1) Tax payable by corporation:

net income	250,000		
combined federal-provincial tax, 48%	120,000		120,000
Available for dividend	130,000		

Tax payable by A,B,C and D:

(Assume each has other income equal to all available deductions)

dividend	32,500		
gross-up	16,250		
taxable income	48,750		
Federal tax	14,171.84		
tax credit	12,187.50	1,984.34	
Provincial tax		873.10	
		2,857.44	
		x 4	11,429
Combined corporate-shareholder tax			$131,429

(2) Tax payable if 250,000 earned directly in equal shares by A,B,C and D.

taxable income	62,500	
Federal tax	19,337	
Provincial tax	8,508	
	27,845	
	x 4	111,380
Tax lost through incorporation		$20,049

4.03 In theory, it may be possible to avoid the above result if each member of the professional corporation forms his own professional corporation and those corporations in turn form a partnership to carry on the professional practice. In that event, depending on the number of corporations involved and the respective shares of each in the partnership profits, it may be possible for each professional corporation to avoid earning more than $150,000 of ABI in any one year. Further, as each separate corporation's CDA approaches zero, it may be possible to preserve the corporation's right to claim the benefit of the low rate by causing the professional corporation to declare dividends in favour of its shareholder. There is some question, however, whether the individual corporations would be regarded as associated corporations for tax purposes. If they were, the benefit of the low rate on the first $150,000 of ABI would have to be divided among the associated group. It is not clear what position the Minister of National Revenue is likely to take on this point,[41] nor is it possible to say with certainty how the courts would decide an appeal from a direction by the Minister that such companies be regarded as associated. Until the point is resolved, the right to incorporate will be of questionable appeal for existing partnerships of more than two or three members, at least as far as current tax effects are concerned.

4.04 A possible trade-off for some larger firms may be the opportunity to establish a registered pension plan to provide for the retirement of professional employees. Under the present rules, professionals are limited to annual deductions of $5,500 for RRSP contributions. If a professional corporation were formed and a registered pension plan established, combined employer-employee

contributions of $7,000 could be made on account of current service each year. It is difficult to generalize about whether this would be a sufficient benefit to offset the net increase in taxes payable because of the intervention of the professional corporation.

PART 5 - TAX IMPLICATIONS OF ALLOWING NON-PROFESSIONAL PERSONS TO ACQUIRE SHARES IN A PROFESSIONAL CORPORATION

Introduction

5.01 In Parts 1 to 4 of this paper, it was assumed that only professionals would be permitted to acquire shares in their professional corporations and the tax implications were considered on that basis. If it is assumed that non-professionals may become shareholders, additional tax savings may be possible. In this Part, it is assumed that any non-professionals who do become shareholders will be members of the professional's family. While there may be other circumstances in which non-professionals will become shareholders (an obvious example is the case of non-professional employees who are allowed to purchase shares), the tax implications of their doing so are essentially the same as those discussed in connection with the professional's right to incorporate.

5.02 If members of the professional's family are allowed to become shareholders in his professional corporation, there is the possibility for tax savings of two kinds. First, taxes payable on dividends paid by the corporation can be reduced without any loss in the combined economic power of the family unit. The magnitude of the saving is wholly dependent on the amount of income available for payment by way of dividend and the number of shareholders involved. Second, on the assumption that the non-professional shareholders acquire participating shares, taxes and succession duties payable on the death of the professional may be reduced.

Reduction of Taxes on Current Distributions of Income

5.03 As pointed out in Part 1,[42] individuals are taxed at progressive rates. Because of this, the same amount of taxable income will bear a larger amount of tax if received by one individual than if received separately by two or more individuals. In the case of a family unit consisting of, say, a husband, wife and minor children, current income taxes can be reduced if professional income earned by one of the spouses is split between the other members of the family.

5.04 There are several provisions in The Income Tax Act designed to limit a taxpayer's ability to avoid the progressive nature of the rate schedule by diverting income to members of his family. The basic provision states, in effect, that income derived from property transferred by the taxpayer to his spouse or to a person under the age of eighteen years, is attributable to the taxpayer notwithstanding the transfer.[43] A somewhat related section provides that where a payment or transfer of property has been made pursuant to the direction of a taxpayer to some other person as a benefit that the taxpayer desired to have conferred on the other person, the amount of the payment or transfer is to be included in computing the taxpayer's income to the extent that it would have been if the payment or transfer had been made to him.[44]

5.05 Thus, it is not possible to split income by the simple expedient of transferring income producing property or assigning the right to receive income to members of the family. However, if the business being carried on by the professional may be incorporated, it is possible to achieve income splitting through the corporation. If members of the family acquire participating shares in the corporation

in circumstances such that the attribution rules do not apply,[45] dividends paid to them on those shares will be taxable in their hands.[46]

5.06 The potential tax saving can be substantial. In the following Table 14, the facts in Table 10[47] are assumed; that is, net professional income of $50,000 earned by a corporation, a salary of $27,500 paid to the professional and a registered retirement savings plan contribution of $5,500 made by the professional in the year. In Table 10, it was also assumed that the balance of after tax income in the corporation ($17,100) was distributed to the professional by way of dividend. In Table 14, it is assumed that the shares of the professional corporation are owned 51% by the professional and 49% by his spouse. Accordingly, of the dividend of $17,100, $8,721 is paid to the professional and $8,379 is paid to the spouse. As the Table indicates, the total taxes payable by the professional and his spouse are $1,991 less than the taxes payable by the professional on the assumptions made in Table 10. This is an effective tax saving of about 18.7%.

TABLE 14 - NET PROFESSIONAL INCOME OF $50,000 EARNED BY A CORPORATION OWNED 51% BY THE PROFESSIONAL 49% BY HIS SPOUSE

Assumptions:
- corporation taxable at combined federal-Ontario rate of 24%
- salary of $27,500 to the professional
- dividend of $17,100:
  - $ 8,721 to professional
  - $ 8,379 to spouse
- RRSP contribution of $5,500 by professional

(1) Tax payable by professional:

salary	$27,500
dividend	8,721
gross-up	4,360
	40,581
RRSP	(5,500)
taxable income	35,081

.../cont'd.

(Table 14 cont'd.)

	Federal tax:		
	-basic tax	$9,251	
	-dividend tax credit	(3,270)	
		5,981	
	Provincial tax	2,631	$8,612
(2)	Tax payable by spouse:		
	dividend $8,379		
	gross-up 4,189		
	taxable income 12,568		
	Federal tax:		
	-basic tax	2,394	
	-dividend tax credit	(3,141)	
		0	
	Provincial tax	0	0
(3)	Total tax payable by professional and spouse		8,612
	Tax payable where professional owns 100% of stock (Table 10)		10,603
	Tax saved		$ 1,991

5.07 The foregoing example is somewhat misleading because it does not take into account personal and other deductions that may be available to the professional and his spouse in computing income.[48] However, it is sufficiently accurate to make the point that a significant tax saving is possible where members of the professional's family are permitted to become shareholders of the professional corporation and there are funds available for distribution by way of dividend. The amount of tax saved in any particular case will depend on the amount of the dividend, the nature of the ownership of the shares and the conditions attaching to the shares on which dividends are paid. If the professional and his spouse have children, it is possible to obtain a further splitting of income by arranging to have some of the participating shares held in a trust for the children. If the terms

of the trust are properly drawn, the trustees will be permitted to treat the dividends received on the shares held by them as income taxable at the rates applicable to the beneficiaries, even though the dividends are not in fact distributed.[49] Accordingly, where the income of the professional corporation available for distribution is such that the dividends paid to the spouse would be taxable,[50] it will be advantageous (in a tax sense) to further split income by arranging to have some of the participating shares held by a trust for minor children.

Taxes and Succession Duties on Death

5.08 Allowing members of the professional's family to become shareholders of the professional corporation may permit a reduction of taxes and succession duties payable on the death of the professional. Under The Income Tax Act, the professional will be treated as if he had sold all of his capital assets on death for purposes of determining the amount of any capital gains and losses in the taxation year ending in death.[51] If the professional owns all of the shares of a professional corporation, this deemed disposition rule may give rise to a capital gains liability in the year of death. To the extent that equity shares of the professional corporation are owned by members of the family, the value of the shares held by the professional will be reduced. To that extent, allowing the family members to become shareholders will result in a saving of tax. A simple illustration of this is set out in Table 15.

TABLE 15 - USE OF PROFESSIONAL CORPORATION TO REDUCE DEEMED CAPITAL GAINS ON DEATH

Assumptions:

- -equity shares owned by the professional and his spouse in the ratio 51:49;
- -increase in value during the period from incorporation to date of death, $150,000;
- -professional taxable at 60% rate (combined federal/provincial) in year of death;
- -professional's shares disposed of by will in circumstances such that subsection 70(6) does not apply.

Calculation of tax payable on deemed capital gain year of death:

-total gain	$150,000
-portion attributable to professional's shares (51%)	76,500
-taxable capital gain (1/2)	38,250
-tax (60%)	22,950
-tax payable if 100% of the shares owned by professional	$ 45,000
-tax saved	$ 22,050

As noted in the assumptions in Table 15, the tax saving in this case only arises if the shares owned by the professional do not pass outright to his wife or to a trust that qualifies under subsection 70(6) for deferral of deemed capital gains on death. Under that subsection, no tax is payable on a deemed disposition at death if the property in question is left to the spouse or to a trust that meets certain conditions.

5.09 Similar observations may be made with respect to the application of The Ontario Succession Duty Act.[52] Under that statute, property passing on death is liable to duty where the aggregate taxable value of the estate exceeds $300,000.[53] If the property of the deceased passes to his spouse, no duty is payable in any event. However, to the extent that property passes to other beneficiaries, duty

will be payable and in these circumstances the taxable value of the estate will be reduced to the extent that equity shares are owned by persons other than the professional.

5.10 Because both The Income Tax Act and The Succession Duty Act permit transfers between spouses on death without liability for income tax or succession duty, professionals are not as prejudiced with respect to planning for taxes on death as they are with respect to planning for taxes on current income, when compared with the position of non-professionals who are allowed to incorporate. However, for professionals who are not married, or who for whatever reason do not wish to leave their assets to their spouses, the rule against incorporation may result in higher taxes becoming payable on death than otherwise would be the case if incorporation were permitted. While it is difficult to estimate the extent to which the unincorporated professional is in fact worse off because of this disability, it can be said that the present rules are discriminatory (at least in theory) and ought to be changed unless there is some other reason for their continued existence.

FOOTNOTES

1. S.C. 1970-71-72, c. 63, as amended to March 1, 1977. Significant amendments were proposed by the Minister of Finance in his budget speech of March 31, 1977. Bill C-56 was read for the first time on June 15, 1977, but died on the Order Paper when Parliament was prorogued on October 17, 1977. It is understood that the government intends to proceed with most of the provisions of former Bill C-56 in the current session (see "Economic and Fiscal Statement" made by the Hon. Jean Chretien, Minister of Finance, Oct. 20, 1977, p. 10) and many of the tables in this paper have been prepared on that assumption.

2. S.O. 1972, c. 143, as am.

3. R.S.O. 1970, c. 217, as am.

4. "Net professional income", when referred to in this paper, means professional income less the deductions therefrom permitted in computing income from a business under the Income Tax Act. Non-source related deductions from income, such as those permitted under subdivision (e) of Part 1 of the federal Act, are excluded in determining "net professional income" as I have used the term in this paper.

5. The issue here is whether the corporation will be regarded as a sham for tax purposes. If it is, the income will be treated as having been earned directly by the shareholders. Whether or not the interposition of the corporation will be regarded as a sham will depend on the facts of each case. Assuming the corporation is properly incorporated and in fact is the entity which conducts the practice, the better view is that the interposition of the corporation will be accepted for tax purposes. See D.I. Matheson, "Service Corporations", (July-August 1976), XXIV Can. Tax J., 329; H.S. Graschuk, "The Professional Corporation in Alberta", (March-April 1977), XXV Can. Tax J., 109; J.G. Ware, "The Business Purpose Test and Sham Transactions", Report of the Proceedings of the 28th Tax Conference, Canadian Tax Foundation, 602. In a number of reported cases, the issue has been considered in the context of whether there was a business purpose for the incorporation, apart from an anticipated tax saving. In MNR v. A.T. Leon et al, [1976] CTC 532 (FCA), Mr. Justice Heald said, in holding that the purported use of a management company was a sham, that "If the agreement or transaction in question lacks a bona fide business purpose, it is a sham". This broad statement was qualified somewhat in Massey-Ferguson Ltd. v. The Queen, [1977] CTC 6 (FCA), where Mr. Justice Urie said "I am not at all sure that I would have agreed with the broad principles relating to the finding of sham as enunciated in that case, and I think that the principle so stated should perhaps be confined to the facts of that case".

For a further discussion of these decisions, see notes by T.E. McDonnell in "Current Cases", (September-October 1976), XXIV Can. Tax J., 468, and (March-April 1977), XXV Can. Tax J., 119, respectively.

In other cases, the purported use of a corporation has been successfully attacked on the basis that subsection 56(4) of the federal Act applied. That subsection provides, in effect, that where a taxpayer assigns his right to receive income to another person with whom he does not deal at arm's length, the taxpayer will be taxable on the amount so assigned: See Kindree v. MNR, [1964] CTC 386 (Ex. Ct.), where the taxpayer, a medical doctor, was taxed on income purportedly earned by a corporation set up to carry on the practice of medicine. It was held that the practice of medicine could only be carried on by a natural person (by reason of s.71 of The Medical Act of British Columbia, RSBC 1960, c. 239.) and that subsection 56(4) applied to bring the amounts into income in the doctor's hands. The decision has been criticized; see S. Silver, "Use of Corporations by Executives and Professionals", Corporate Management Tax Conference, 1973, Canadian Tax Foundation, 83 at 87. The opposite result was reached in Sazio v. MNR, [1968] CTC 579 (Ex. Ct.), in which a football coach formed a corporation to provide coaching services. The Court referred to the fact that, unlike the situation in Kindree, there was no legal reason why the business of coaching could not be carried on through a corporation.

The current view of the Department of National Revenue is set out in Interpretation Bulletin IT-189, "Corporations Used by Practising Members of Professions".

6. Section 117.

7. Subsection 117.1(1).

8. In his Economic and Fiscal Statement of October 20, 1977, the Hon. Jean Chretien, Minister of Finance, announced that the brackets would be adjusted by a factor of 7.2% for the 1978 tax year - p. 44. The tables that follow in this paper have been prepared on the basis of the 1977 brackets.

9. The Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977 (Bill C-37, Royal Assent given March 31, 1977.)

10. Section 248 of the federal Act, the definition of "business".

11. Section 121.

12. More accurately, the credit will exceed the tax in the case of "investment income" within the meaning of subsection 129(4) of the federal Act.

13. This point is developed at greater length below.

14. Paragraph 89(1)(g).

15. Paragraph 89(1)(f).

16. Paragraph 125(5)(a).

17. "Active business income" is not defined in the Act, but is used in section 125 of the Act to describe the type of income which qualifies for the reduced rate of corporate tax. The meaning of the phrase was considered by the Federal Court of Appeal in The Queen v. Rockmore Investments Ltd., [1976] CTC 291. There is little doubt that the income earned from the conduct of a professional business would qualify as active business income.

18. Subsection 129(4).

19. Subparagraph 129(4)(a)(iii).

20. Section 123.

21. Section 125.

22. This comes about by reason of paragraph 125(1)(d) which provides, in effect, that the amount of income qualifying for the reduced rate cannot exceed $750,000 less the amount in the corporation's "cumulative deduction account". This latter account is, roughly speaking, equal to the taxable incomes of the corporation for each year since 1971, less 4/3 of all taxable dividends paid in those years: paragraph 126(5)(b). To the extent that the corporation pays taxable dividends it reduces its cumulative deduction account and extends its right to claim the reduced rate.

23. Subsection 129(1), as amended by paragraph 58 of Bill C-56 (1977).

24. Subsection 129(3), as amended.

25. Ibid.

26. As developed more fully below in paragraph 1.14, the taxpayer is in fact slightly better off in the case of investment income for having earned it through a corporation.

27. These terms are defined in subsection 129(4).

28. S.O. 1972, c. 143, as am.

29. The Corporations Tax Act, s. 123.

30. Subsection 126(1).

31. Subsection 131(1).

32. Section 248 of the federal Act, "Registered Pension Fund or Plan".

33. Only past service with the corporation is eligible. If professionals are allowed to incorporate, past service with a partnership prior to incorporation would not qualify.

34. Subsection 146(5).

35. Subsection 120(3.1), as am.

36. Of particular importance are the deductions permitted by S.60, which are not specifically related to income from a particular source.

37. The significant deductions here are those allowed by sections 109 and 110, the personal status, charitable gift and medical expense deductions.

38. As noted in the Introduction, this limitation exists in the legislation in force in Alberta and most of the United States.

39. Subsection 74(3).

40. Paragraph 125(6)(b).

41. Under subsection 247(2) the Minister may direct that two or more corporations are to be regarded as associated in the year if he is satisfied that:
(a) the separate existence of the corporations in the year is not solely for the purpose of carrying out the business of those corporations in the most effective manner, and
(b) one of the main reasons for such separate existence in the year is to reduce the amount of taxes that would otherwise be payable under the Income Tax Act.
It is understood that Revenue Canada has refused to give a ruling that subsection 247(2) would not be applied to associate a group of professional corporations that form a partnership to carry on the practice of a profession in Alberta: Graschuk, op. cit., footnote 5. There have been no reported cases as yet, although there are a good number of reported decisions in which subsection 247(2) was relied upon by the Minister in other fact situations. See, generally, Canada Tax Service, (Richard De Boo Ltd., Toronto), Vol. 4, pp. 247-201 to 302.

42. At para 1.02 and ff.

43. Subsections 74(1) and 75(1) respectively. These subsections are referred to hereafter as the attribution rules.

44. Subsection 56(2).

45. The essential point here is that the shares be acquired by the family members with their own funds by way of subscription for treasury shares. If the shares are transferred to them by the professional, or if he gives them the money to purchase the shares, the attribution rules will apply. On the other hand, the professional may make a loan to the family members to enable them to purchase the shares without concern for the attribution rules as long as the loan is bona fide and not a disguised gift. See Hansen, "The Definition of 'Transfer' in Sections 74 and 75 - Judicial Nonsense", (November-December 1976), XXIV Can. Tax J. 612.

46. There is an assumption here that the family members will be regarded as "legitimate" shareholders for tax purposes. In Titeley vs. MNR, [1977] CTC 2045 (TRB), the wife of the taxpayer acquired all of the non-voting shares of a corporation formed to acquire the assets of her husband's business. The shares were non-voting but entitled to receive dividends; she paid 20¢ for them. Her husband acquired a second class of shares which had voting rights but no right to dividends. The taxpayer exercised his voting power to declare substantial dividends on the shares held by his wife. It was held that the dividends so paid were taxable to him under subsection 56(2). The facts in this case were extreme in that the wife's investment was nominal, she made no other contribution to the well-being of the company and the taxpayer was precluded from ever receiving dividends because of the conditions attaching to his shares. Where the circumstances are such that the spouse in fact makes an appreciable contribution of capital, or becomes involved in the affairs of the company, and the taxpayer retains the right to a reasonable dividend on his share, it may be that the Titeley principle does not apply, although it is as yet too soon to say to what extent the spouse must be "involved" in the corporation to avoid the application of subsection 56(2).

47. P. 184.

48. No attempt has been made here to assess the tax benefit which the corporation may obtain if taxable dividends are paid. In fact, there will be circumstances in which the payment of dividends will be desirable, looking just at the corporate tax consequences. Under section 125 of The Income Tax Act the federal rate is reduced to 15% (after taking into account the provincial abatement of 10%) provided the corporation's total business limit, less the amount of its cumulative deduction account, does not exceed $750,000. Since the cumulative deduction account is reduced by 4/3 of each $1.00 of taxable dividends paid (subparagraph 125(5)(b)(iii)) payment of taxable dividends will permit the corporation to prolong its entitlement to the reduced rate of tax on its active business income.

49. If the trust was settled by the professional, his children will be preferred beneficiaries and the election provided for in subsection 104(13) can be made. Under that subsection, the accumulating income of the trust (in this case, dividends received but not distributed by the trust) may be treated as dividends paid to the beneficiaries and taxable at their marginal rates.

50. Depending on whether or not the spouse has income from other sources, she may be able to receive upwards of $30,000 in dividends before any federal or provincial tax is payable.

51. Subsection 70(1). A special rule applies in the event that the property passes to the wife or to a qualifying trust for her benefit: subsection 70(6).

52. R.S.O. 1970, c. 499, as amended.

53. Ibid., as am. April 20, 1977.

MEMORANDUM ON THE NOVEMBER 16, 1978 FEDERAL BUDGET

APPENDIX TO WORKING PAPER #6,
THE TAX IMPLICATIONS OF PERMITTING
THE BUSINESS OF A PROFESSION TO BE
CARRIED ON THROUGH A CORPORATION
IN ONTARIO

Prepared by:

Robert Couzin
Barrister and Solicitor
Toronto, Ontario

for
The Professional Organizations Committee

December 28, 1978

Introduction

The purpose of this appendix is to briefly re-evaluate the discussion and conclusions regarding the tax implications of allowing professionals to conduct their practices through a corporation in Ontario in light of the fundamental changes in the income tax system as it relates to the taxation of an incorporated professional practice announced on November 16, 1978. 1/

J. R. S. Prichard concludes in his working paper for the Committee that the tax aspects of incorporation represent a fundamental criterion likely to influence the decision of professionals in Ontario if such incorporation is permitted. 2/ He observes:

> "The striking feature of the non-tax advantages and disadvantages of professional incorporation is how relatively inconsequential they appear to be....
>
> "Unfortunately, this analysis is incomplete; it assumes that only non-tax considerations will influence the individual firm's decision of whether or not to incorporate. Clearly, in an environment of significant differential tax treatment of partnerships and corporations, the non-tax considerations will be supplemented, and indeed often dominated, by the tax considerations." 3/

The income tax considerations of professional incorporation have previously received the attention of tax policy-makers. Within Revenue Canada, Taxation the official attitude towards such

corporations and other incorporated service activities is public knowledge. 4/ Prichard felt that the Committee probably should nevertheless consider the tax implications of professional incorporation. He observed:

> "While this view of specialized responsibilities certainly eases the task of a particular policy-making institution, it may ignore at least two important factors. Firstly, in its extreme form, it assumes a probably unrealistic degree of refinement in institutional interaction. That is, the view assumes that each institution will respond expeditiously to environmental changes caused by other policy-making institutions so as to ensure that its mandate is fulfilled on a continuous basis. Given technocratic and bureaucratic imperfections, it may at times be incumbent upon specialized institutions to consider the probable actions (or lack thereof) of other institutions in formulating their policy recommendations." 5/

In this case, the institutional forces of tax reform appear to have reacted more swiftly than anticipated.

The November 16, 1978 Budget Proposals

The thrust of the budget proposals which are relevant to the incorporation of professionals in Ontario, as altered by subsequent material, is that with respect to taxation years commencing after 1979 (after 1978 for new corporations) the special low rate of tax, often referred to as the "small business deduction", will cease to be available in certain cases. The workings of this incentive are elaborated by McDonnell. 6/ Among the proposals is

one to the effect that active business income (ABI, in McDonnell's working paper) should no longer include the profits of certain incorporated professionals.

At the time of writing, implementing legislation has not yet been enacted. This analysis is, therefore, based upon the documents tabled by the Minister of Finance on November 16, 1978 plus an "amplification" issued that evening by his Department, and upon a more detailed Notice of Motion, press release and draft regulations tabled on December 19, 1978. Annexes 1 through 6 reproduce, respectively, the relevant paragraph of the Notice of Ways and Means Motion to Amend the Income Tax Act (1), portions of the Supplementary Information (2), an extract from the Budget Speech (3), the Departmental amplification entitled "The Small Business Deduction" (4), extracts from the December 19 Notice of Motion (5) and the December 19 press release and draft regulations (6). In the absence of any definitive text, we shall assume that the proposal will be so framed as to be effective in entirely eliminating the tax benefit associated with the incentive for small businesses in the prescribed cases. 7/

With respect to provincial taxation, it should be observed that under the existing provisions of The Corporations Tax Act, 1972 of Ontario, the federal proposals once enacted will automatically apply to deny the provincial incentive as well. 8/

Proposed income tax treatment of incorporated professions

The impact of the budgetary proposals is to remove the preferential low rate of tax from active business income earned

by certain professional corporations. The effect would be to subject such income to the ordinary corporate tax rate of 49% in lieu of the 25% rate applicable to qualifying active business income. 9/ Since the higher rate of tax will apply to each professional corporation, the potential mitigating effects of a partnership of corporations discussed by McDonnell would no longer be relevant. 10/

A most important change was made upon publication of the draft regulations on December 19. The original Department of Finance release (Annex 4) stated that there would be excluded from the small business deduction:

> "A business carried on by a corporation if all its shareholders do not have limited liability with respect to all the business activities of the corporation. This would exclude professional corporations formed by doctors, lawyers, dentists and accountants."

The draft regulations (Annex 6) are rather differently framed. They would exclude:

> "(b) "non-qualifying business" carried on by a corporation in a taxation year means
>
> (i) the professional practice of an accountant, dentist, lawyer or medical doctor that is not permitted under the law of one or more provinces to be carried on by a corporation,"

As none of the other categories of "non-qualifying business" are likely to apply in this context, it would appear that this proposal,

if enacted, would affect the conclusions drawn by McDonnell as follows:

(i) his analysis would continue to apply in the case of architects and engineers;

(ii) his analysis would apply to members of the legal and accounting professions only after such time as all provinces have enacted legislation to permit the incorporation of their practices, and

(iii) the income tax treatment of members of the legal and accounting professions would be substantially different commencing in 1980 and prior to the eventuality described in (ii).

The balance of these notes will be addressed to the results of paragraph (iii), the withdrawal of the small business incentive.

Income tax effects of withdrawing incentive

McDonnell determined, applying the lower rate of tax, that the "break-even point", at which neutrality is achieved as between earnings in a corporation taxed at the low rate and personal earnings, is about $8,000. 11/ Applying the higher corporate rate, the equivalent figure is $87,335. 12/ That is to say, at this level of taxable income, an individual and a corporation pay roughly the same amount of tax if the small business deduction does not apply.

However, as McDonnell observes, this calculation is misleading in that it does not take into account the tax consequences of the corporate distribution of after-tax earnings. 13/

Herein lies the crucial difference between active business income taxed at the ordinary corporate rate and active business income taxed at the preferential rate applicable to small businesses. Regardless of the professional's level of income, leaving aside other potential tax advantages such as spousal employment and deferred income plans (discussed below), there is a tax disadvantage to earning active business income in a corporation if it is taxed at the high rate. McDonnell reaches the same conclusion, but at the time of his study it was relevant only in the case of professionals or professional partnerships earning in excess of the $150,000 annual limit or the $750,000 cumulative limit in respect of the small business deduction. 14/ With the elimination of the incentive to small businesses in the case of certain professional corporations, this disadvantage becomes the norm. Thus, table 13 of McDonnell's working paper can be used at any income level to determine the tax lost through incorporation. For example, using 1978 personal and corporate tax rates and assuming taxable income from a non-qualifying profession of $50,000, all of which is distributed in the case of a corporation, the result is approximately as follows:

(1) Tax payable by corporation:

Net income	$50,000	
Combined federal-provincial tax, 49%	(24,500)	24,500
Available for dividend	25,500.	

Tax payable by professional-shareholder (Assume other income equal to available deductions, and no children)

Dividend	25,500	
Gross-up	12,750	
Taxable income	38,250	
Federal tax on taxable income	10,150	
Dividend tax credit	(9,562)	
Basic federal tax	587	
General tax reduction	(253)	
Federal tax	334	
Provincial tax	258	
Total personal tax	592	592
Combined corporate-shareholder tax		25,092

(2) Tax payable if $50,000 earned directly by professional

Taxable income	50,000	
Federal tax	13,880	
Provincial tax	6,327	
Total tax	20,207	20,207
Tax lost through incorporation		4,885

This example is unrealistic, as is McDonnell's Table 13, because it assumes no salary is paid. However, it does accurately reflect the tax disadvantage on $50,000 of income in excess of whatever is paid by way of salary. That is, if a professional earns $100,000 through a corporation and pays himself a salary of $50,000, the above table indicates the disadvantage relating to the balance.

We may therefore conclude that the on-going advantage of professional incorporation of lawyers and accountants where the professional income of the corporation is currently distributed will have been replaced by an on-going disadvantage if the budgetary proposals are enacted. It remains true that income earned by the corporation which is not distributed may be taxed initially at a rate which is lower than that of the individual. The marginal tax rate on individuals reaches 49% when taxable income exceeds $36,500, and at that point, deferral of tax would become attractive if the future tax on distribution were discounted to nil. At higher income levels, deferral does have a positive value, however, the saving would have to be significant to offset the real loss inherent in professional incorporation under the budgetary proposals.

The remaining potential tax advantages

The budgetary proposals do not remove all of the potential tax advantages referred to by McDonnell. Perhaps the most important in practice is the potential employment of the spouse. 15/ The anomalous treatment of spousal employment (disallowing salary paid by the sole proprietor spouse) persists. The value of the deduction for spousal salaries depends upon how large such a salary may reasonably be paid, the spouse's other income and the professional income.

The comments made by McDonnell in Part 2 of his paper also remain apt. There has been no attempt in the federal budgetary proposals to affect deferred income arrangements of a professional corporation. McDonnell concluded that the benefit,

for example, of a registered pension plan in the case of a professional corporation paying tax at the higher rate is measurable but "it is difficult to generalize about whether this would be a sufficient benefit to offset the net increase in taxes payable because of the intervention of the professional corporation". 16/

The tax implications of allowing non-professional shareholders is reviewed by McDonnell in Part 5 of his working paper. A useful re-evaluation of maximal benefits flowing from incorporation may be achieved by combining McDonnell's Tables 12 and 14. The following example shows the combined effect of deducting a salary to the professional's spouse, benefiting of maximum use of deferred income plans 17/ and splitting distributions between spouses. 18/ The assumptions are otherwise the same as those in the preceding example.

Assumptions

Non-qualifying professional income of $50,000
Deferred profit sharing plan contribution to $3,500
Salary to professional of $27,500
Salary to spouse of $7,000 (spouse's other income equals available deductions)
Spouses contribute maximum to RRSP
Shares held 51% by professional, 49% by spouse.

(1) Tax payable by corporation

Income		50,000	
Salary to prof.	27,500		
Salary to spouse	7,000		
DPSP	3,500		
	38,000	(38,000)	
Taxable income		12,000	
Combined federal-provincial tax, 49%		5,880	5,880
Available for dividend		6,120	

(2) Tax payable by professional

Salary	27,500	
Dividend	3,121	
Gross-up	1,561	
	32,182	
RRSP	(5,500)	
Taxable income	26,682	
Federal tax on taxable income	6,378	
Dividend tax credit	(1,171)	
Basic federal tax	5,207	
General tax Reduction	(500)	
Federal tax	4,707	
Provincial tax	2,291	
Total personal tax	6,998	6,998

(3) Tax payable by spouse

Salary	7,000	
Dividend	2,999	
Gross-up	1,499	
	11,498	
RRSP	(1,400)	
Taxable income	10,098	
Federal tax on taxable income	1,801	
Dividend tax credit	(1,124)	
Basic federal tax	678	
General tax Reduction	(261)	
Federal tax	417	
Provincial tax	298	
Total personal tax	715	
Tax on corporation + professional + spouse		13,593

(4) Tax payable if $50,000 earned directly by professional (see table above) 20,207

Tax saving 6,614

Apart from the additional savings element of this example (the DPSP), it is precisely comparable to the previous table and demonstrates that the income splitting aspects of incorporation may overcome the inherent disadvantage of earning business income taxed at a 49% rate.

Finally, with respect to taxes on death, McDonnell's observations continue to apply. That is to say, the taxes on death would certainly be reduced by a split shareholding although this is not to say that the tax would be reduced as compared to the tax payable if there were no incorporation at all. It should also be noted that certain preferential rules applicable on death under both federal and provincial legislation would not apply to the non-qualifying professional corporation. Under the Income Tax Act, up to $200,000 of deemed capital gain realized on death may be deferred where the gain is in respect of shares of a corporation which are bequeathed to children. This rule will not apply to the non-qualifying professional corporation. 19/ Similarly, certain advantages under The Succession Duty Act of Ontario are applicable only to shares of a corporation which qualified for the small business deduction. 20/

Conclusion

If the budgetary proposals are enacted, the result would be to remove the tax advantages of incorporation of certain professional practices derived from the small business deduction. There would be a net tax disadvantage to such incorporation where the corporation is owned by the professional and the spouse is not employed by it. However, other benefits remain in cases where

spousal employment, income splitting or deferred income plans are practicable.

The proposals may, therefore, mark the end of serious speculation by many professionals about the future incorporation of their practices, at least for the time being. For others the income splitting aspects will continue to be sufficiently attractive to justify this form of practice. The fact that the disadvantage will automatically cease when all provinces permit professional incorporation may be relevant to the decision-making process in Ontario.

Footnotes

1. The point of reference is the working paper prepared for The Professional Organizations Committee by Thomas E. McDonnell, "The Tax Implications of Permitting the Business of a Profession to be Carried on Through a Corporation in Ontario", (1978).

2. J. R. S. Prichard, "Incorporation by Professionals", (1978) at page 50.

3. Ibid pp. 50, 52.

4. "Tax investigators to focus on personal corporations", The Globe and Mail Report on Business, August 10, 1978, reporting on an internal memorandum dated May 24, 1978 over the signature of Mr. J. L. Gourlay, Director General of the Audit Directorate, Revenue Canada, Taxation.

5. Prichard, supra n. 2, pp. 58-59.

6. McDonnell, supra n. 1, para. 1.10.

7. The intention, as expressed in the December 19 Notice of Motion is not to deem the active income of a professional corporation to be "passive" income. Such income, while taxed at full corporate rates, does benefit of a different sort of integration upon distribution (see McDonnell, supra n.1, para. 1.11).

8. This is because the Ontario incentive is defined by reference to the federal Income Tax Act. See The Corporations Tax Act, 1972, S.O. 1972, c.143, as amended, section 36.

9. McDonnell refers to rates of 24% and 48%. Those were the rates in force at the time his working paper was prepared. The Province of Ontario has since increased its corporation income tax rate by one percentage point.

10. McDonnell, supra n. 1, para. 4.03.

11. McDonnell, supra n. 1, para. 3.01, Table 8. This is a highly simplified example, as noted by McDonnell.

12. For ease of comparison, 1977 personal and corporate income tax rates have been used in arriving at this figure.

13. McDonnell, supra n. 1, para. 3.02.

14. McDonnell, supra n. 1, para. 4.02.

15. McDonnell, supra n. 1, para. 3.07.

16. McDonnell, supra n. 1, para. 4.04.

17. The deferred profit sharing plan deduction is made on the assumption that such a plan would be available, i.e. this is not a one-man corporation.

18. Like McDonnell, I have limited myself to assuming a 49% shareholding by the spouse. If permitted, more extreme income splits could be calculated by giving a greater shareholding to the spouse or introducing the children to the example.

19. Income Tax Act, RSC 1952, c.148 as amended, subsection 70(9.4), (11), and paragraph (27) of the original Notice of Motion.

20. The Succession Duty Act, RSO 1970, c.449, subparagraph 17c(1)(c)(iv).

Annex 1

Extract from Notice of Ways and Means Motion to Amend the Income Tax Act. November 16, 1978.

Small Business Deduction

(42) That for taxation years commencing after 1978, the small business deduction apply only to the income from manufacturing, processing, mining, operating an oil or gas well, prospecting, exploring or drilling for natural resources, construction, logging, farming, fishing, leasing property other than real property, selling property as a principal, transportation or other qualifying business.

Annex 2

Supplementary Information

This provision has assisted in increasing the supply of housing across Canada. This extension is designed to increase the number of multiple-unit residential starts in 1979 and provide employment opportunities during the coming winter months.

The MURB provision permits the offset against other income of rental losses generated by capital cost allowances.

Provision is made in the budget for the deduction of interest and property taxes on land held for development or resale by taxpayers in the ordinary course of their business. This will apply to such expenses incurred after November 16, 1978. It will provide developers an opportunity for planning more projects in Canada.

The Small Business Tax Incentive

The budget proposes a more precise definition of who may benefit from the low tax rate on small business, to ensure that this tax incentive will serve its original purpose of promoting expansion of small business and not be used as a tax shelter by others.

Incorporated Canadian small business enjoys very favourable tax treatment. Canadian-controlled private corporations qualify for a federal tax rate of 15 per cent on the first $150,000 of annual business earnings (10 per cent for small manufacturing firms). These tax rates compare with the 36 per cent federal tax rate (30 per cent for manufacturing) which applies to corporations not qualifying as small businesses. Since 1972, the government has tripled the annual amount of income eligible for the small business tax rate. The low tax rate applies as long as the small corporation's retained business income is less than $750,000. Once this limit is reached, the small business can continue to qualify for the low tax rate by paying dividends to shareholders.

This low tax rate on small business results in a reduction of some $900 million annually in federal tax revenues.

Last summer the government introduced other measures for small business. They included a deferral on up to $200,000 of capital gains when small family businesses are transferred from parents to children or grandchildren. Losses on investments in Canadian-controlled private companies were made deductible against income from other sources without limit, compared with the $2,000 limit for other investments. Small manufacturers with sales under $50,000 were exempted from federal sales tax.

The low tax rate on small incorporated businesses allows the shareholder-manager, who would otherwise be taxed at personal income tax rates exceeding the small business rate, to defer personal income tax by retaining income in the corporation. In conjunction with the dividend tax credit, the combined personal and corporate tax on small business income earned in a private corporation and distributed to shareholders is well below that on the

same amount of income earned as salaries or wages or as unincorporated business income.

The small business incentive is intended to enable and assist growing, Canadian-controlled firms to accumulate funds for expansion. It was never intended to be a tax shelter device for employment, professional and investment income. Yet, in part, this is what it has tended to become.

More specifically, the corporate tax advantages to small business have caused many individuals and groups of professionals to consider incorporating themselves. In recent years, a number of businesses have been incorporated to provide the personal services of athletes and entertainers or to provide professional or management services. For example, some lawyers, chartered accountants, doctors, dentists and other professionals have formed private companies to provide administrative services to their professional practices. The fees charged by such service companies effectively convert professional earnings into income qualifying for the small business tax rate. Typically, these companies are owned by other members of the professional's family.

Generally speaking, the principal reason for incorporating these types of businesses is to realize the tax saving from the lower tax rate applying to small businesses. Other advantages of the corporate form of organization, such as limited liability, are usually a secondary consideration. For example, limited liability is not generally available to professionals setting up a professional corporation in those jurisdictions where it is permitted. They seek only the tax advantages of incorporation.

When the small business deduction was introduced, provincial legislation did not generally allow individuals to carry on their professional practice through a corporation. There is now greater pressure on provinces, who do not permit professionals such as doctors and lawyers to incorporate, to introduce enabling legislation. If action is not taken, a situation could develop whereby virtually all professional earnings in Canada would be taxed at a federal corporate tax rate of 15 per cent.

It was never intended that an individual providing a personal service be permitted to defer and reduce his taxes by setting up a corporation and leaving part of his earnings in the corporation.

This growing practice has given such individuals an unfair tax advantage in comparison with employed persons who cannot use the same tax advantage.

There are also other areas where the application of the small business tax rate is not appropriate. As a result of court decisions, the income eligible for the small business deduction (that is, active business income) has been broadened to include passive investment-type income. For example, it has been held that income from the holding of mortgages and real estate rentals qualifies for the low tax rate applicable to small businesses.

Changes are proposed in order to ensure that the original intention of these tax benefits is preserved. The term "active business" will be defined so as to direct the benefits of the small business incentives to those Canadian-controlled private corporations that engage in specified activities. These changes will eliminate the undue deferral and reduction of tax in other cases.

"Active business" will include the business of manufacturing, processing, mining, operating an oil or gas well, prospecting, exploring or drilling for natural resources, construction, logging, farming, fishing, leasing property other than real property, retailing, wholesaling, transportation and other prescribed businesses.

In this way the very favourable tax provision will apply to small businesses that need funds to expand and create jobs.

These changes are effective for taxation years beginning after 1978.

Income Bonds and Certain Preferred Shares

The budget will remove a favourable tax treatment for income bonds or debentures and term or retractable preferred shares that are issued after November 16, 1978.

Income bonds and debentures are obligations on which interest is payable only when the borrower has made a profit. They were originally provided for in the Income Tax Act in the 1930s to help companies in serious financial difficulty. Retractable preferred shares, of more recent origin, may be redeemed at the holder's option, and term preferred shares are now frequently issued for a limited period, often less than 10 years.

These types of securities have been considered for tax purposes as equity investments, although they are essentially debt obligations. As a result, income earned by banks and other financial institutions on such securities is received as tax-free dividends rather than as fully taxable interest.

Increasingly, however, these types of securities have been used instead of traditional debt financing, principally for major loans by chartered banks to large corporations. The annual cost of this favourable tax treatment to federal and provincial treasuries has increased to an estimated $500 million. This form of financing is growing rapidly and so the revenue loss is increasing.

The budget proposes legislation to ensure that, except in limited circumstances, interest and dividends paid on new issues of such securities will be treated as interest for tax purposes. This will not apply to a security issued pursuant to a written agreement made prior to November 17, 1978.

The new provision will, however, apply after today whenever the conditions of any existing income bond or debenture, retractable or term preferred share are altered, the term is extended, or the holder waives his right to redeem.

Annex 3

Budget Speech

As a result of tax benefits introduced by this government over the past few years, small businesses in Canada enjoy very favourable tax treatment. Small Canadian-controlled private corporations pay federal income tax at less than half the normal corporation rate. The dividends they pay qualify for the generous dividend tax credit. As a result, the total tax on income from small incorporated businesses is below the level of personal tax on the same amount of wage and salary income.

Mr. Speaker, the very generosity of the measures makes it essential to ensure that they are effectively targetted. Some individuals have rearranged their affairs simply to make their personal, professional and investment income eligible for taxation at the low small business rate. It would be wrong to allow such practices to continue.

I am introducing changes to the Income Tax Act to ensure that the application of the low corporate tax rate is reserved for those small businesses for whom it is really intended. These will include those engaged in manufacturing, processing, mining, construction, farming, fishing, logging, transportation, wholesale and retail trade and other businesses as may be prescribed. In this way the generous tax incentives will be maintained for small businesses that need capital to expand and create jobs. The new measure will apply to taxation years starting next year.

Annex 4

Department of Finance Release

The Small Business Deduction

Paragraph 42 of the Ways and Means Motion identifies those Canadian-controlled private corporations that will qualify for the small business deduction. These include corporations engaged in the business of manufacturing, processing, mining, operating an oil or gas well, prospecting, exploring or drilling for natural resources, construction, logging, farming, fishing, leasing property other than real property, selling property as a principal, transportation or other qualifying businesses.

"Other qualifying businesses" will include most other small businesses. However, it will not include four general categories:

(a) A business carried on by a corporation if all its shareholders do not have limited liability with respect to all the business activities of the corporation. This would exclude professional corporations formed by doctors, lawyers, dentists and accountants.

(b) A business the income of which is derived principally from the personal services of individuals who are either themselves shareholders of the corporation or related to its shareholders. This would include a corporation formed by an executive, athlete, entertainer, consultant, commission salesman or other person for the principal purpose of providing his personal services. It would also include any corporation formed by the spouse or children of any such person. In addition, a corporation formed not only by the individual himself, but also by one or more associates for the purposes of providing their personal services would not qualify for the small business incentive. However, if the income of a corporation controlled by such a person is derived in substantial part from the services of employees who are not shareholders or from services that are not considered as personal services, the corporation would qualify for this incentive. If the corporation is formed, for example, by a consultant simply as the vehicle for providing his consulting services, the business would not be eligible for the small business deduction. However, if a substantial part of the income of the consulting firm is derived from services of employees other than shareholders, the business would qualify.

(c) A business of a corporation formed for the principal purpose of providing managerial or administrative services to a related business. This would exclude, for example, a corporation formed by doctors, lawyers, accountants, dentists or their spouses or children for the purpose of providing managerial and administrative services to that business.

(d) A business of a corporation the income of which consists of income from property held by the corporation other than property used by it principally for the purpose of gaining or producing income from a qualified business of the corporation. The incidental interest income of a manufacturer, for example, would qualify for the small business deduction. However, the interest income of a company formed for the purpose of holding an investment portfolio of securities would not qualify.

It should be noted that the new provisions relating to the small business deduction take effect only for taxation years beginning after the end of 1978.

Department of Finance
Ottawa
November 16, 1978

Annex 5

Extract from Notice of Ways and Means Motions to amend the Income Tax Act and the Income Tax Application Rules, 1971 tabled by the Minister of Finance in the House of Commons on December 19, 1978.

(3) Subsection 125(6) of the said Act is further amended by adding thereto the following paragraphs:

"Active business"

"(*d*) "active business" carried on by a corporation in a taxation year means the business of manufacturing or processing property for sale or lease, mining, operating an oil or gas well, prospecting, exploring or drilling for natural resources, construction, logging, farming, fishing, leasing property other than real property, selling property as a principal, transportation or any other qualifying business carried on by the corporation;

"Income of the corporation for the year from an active business"

(*e*) "income of the corporation for the year from an active business" means the income of the corporation from an active business carried on by it, including any income pertaining to or incident to that business and amounts deemed by subsection 129(6) to be income from an active business, but does not include income from any business other than an active business carried on by the corporation, or income for the year from a source in Canada that is a property held for investment (within the meaning assigned by subsection 129(4.1); and

"Qualifying business" and "non-qualifying business"

(*f*) "qualifying business" and "non-qualifying business" carried on by a corporation in a taxation year have the meanings prescribed by regulation."

(4) Subsections (1) and (3) are applicable to taxation years commencing after 1979 in respect of corporations in existence on November 16, 1978 and to taxation years commencing after 1978 in any other case.

(3) Le paragraphe 125(6) de ladite loi est en outre modifié par l'adjonction des alinéas suivants:

«entreprise exploitée activement»

«*d*) «entreprise exploitée activement» par une corporation dans une année d'imposition désigne une entreprise de fabrication ou de transformation de biens aux fins de la vente ou de la location, une entreprise d'exploitation minière, d'exploitation d'un puits de pétrole ou de gaz, de prospection, d'exploration ou de forage en vue de la découverte de ressources naturelles, de construction, d'exploitation forestière, d'exploitation agricole, de pêche, une entreprise qui donne des biens en location autres que des biens immeubles, une entreprise de vente de biens à titre de commettant, une entreprise de transport, ou toute autre entreprise non admissible exploitée par la corporation;

«revenu de la corporation pour l'année provenant d'une entreprise exploitée activement»

e) «revenu de la corporation pour l'année provenant d'une entreprise exploitée activement» désigne le revenu de la corporation provenant d'une entreprise exploitée activement par la corporation, y compris tout revenu qui se rapporte directement ou de manière accessoire à cette entreprise et les montants réputés aux termes du paragraphe 129(6) être un revenu provenant d'une entreprise exploitée activement, mais ne comprend pas un revenu provenant de toute entreprise autre qu'une entreprise exploitée activement par la corporation ou un revenu (pour l'année tiré d'une source au Canada qui est un bien détenu à titre de placement au sens du paragraphe 129(4.1)); et

«entreprise admissible» et «entreprise non admissible»

f) «entreprise admissible» et «entreprise non admissible» exploitée par une corporation dans une année d'imposition ont le sens que leur accordent les règlements.»

(4) Les paragraphes (1) et (3) s'appliquent aux années d'imposition débutant après 1979 dans le cas des corporations qui existaient le 16 novembre 1978 et aux années d'imposition débutant après 1978 dans tous les autres cas.

Information Canada
Department of Finance
Ottawa, Ont. K1A 0G5
(613) 992-1573

Ottawa, Ont. K1A 0G5
(613) 992-1573

Immediate release

Ottawa, December 19, 1978
78-145

Finance Minister Jean Chrétien today issued draft regulations setting out the revised rules under which small business corporations will qualify for the small business tax deduction. The proposal to revise these rules was announced in his November 16 budget.

The Minister also tabled in the House of Commons an expanded Notice of Ways and Means Motion on budget measures. The Motion contains technical details normally provided by a bill.

He said that both the regulations and the Motion reflect the extensive and very useful submissions that have been made to him since the budget, and that he would consider carefully all other representations made to him prior to the introduction of the bill after Parliament reconvenes in the New Year. He indicated further that the rules relating to the small business tax deduction would not be made final until he is satisfied that all points raised have received full examination.

This procedure, according to Mr. Chrétien, demonstrates the increased importance he attaches to public discussion of budget proposals and to the opening up of the budgetary process.

In order to allow existing corporations ample time for adjustment, the revised rules on the small business tax deduction will not apply to them before 1980. Specifically, in the case of corporations in existence on November 16, 1978, the measure will go into effect for taxation years beginning after 1979. For corporations formed after that date, they will apply for taxation years beginning after 1978.

Mr. Chrétien said the changes in the small business tax rules are essential to ensure that the generous tax treatment of small business corporations goes to those for whom it was intended, and that individuals in similar circumstances pay the same federal tax regardless of the province in which they live.

The total federal tax on income earned through a small business corporation is significantly less than the tax on ordinary employment income. Thus there is a natural tendency for individuals to form corporations for tax reasons. The cost of this special small business tax treatment is already approaching $1 billion a year and its extension to those for whom it was not intended would lead to a heavier tax load on other taxpayers.

The draft regulations deal with four problem areas related to the small business deduction -- the incorporated professional, the incorporated employee, the related service corporation and the investment corporation.

The professional income of doctors, dentists, lawyers and accountants will not qualify for the small business tax incentive. The Minister said that the decision of one province to permit professionals to incorporate had made the matter more urgent. To permit the small business tax deduction in such cases would create considerable unfairness in the federal tax structure as between provinces. For example, for a professional with $50,000 professional earnings, the tax saved through incorporation is about $5,000 a year, and in many cases greater.

Concerning incorporated employees, Mr. Chrétien said the small business deduction should not be available to individuals who, in corporate form, provide essentially the same services as employees. Accordingly, the draft rules provide that, where more than two-thirds of the gross revenue from services provided by a corporation is derived from one client, the income will not qualify for the tax incentive unless the corporation employs more than five full-time employees.

For example, a general insurance agency which provides services to many customers and sells insurance on behalf of several insurance companies, would qualify for the tax incentive. On the other hand, an executive whose services are provided through a corporation to essentially one business would not qualify for the small business tax incentive.

A business that derives its income principally from property held for investment such as bonds, mortgages and real property, will qualify for the small business incentive only if the corporation has more than five full-time employees. Investment income not qualifying for the small business tax incentive will continue to qualify for tax integration and so the combined corporate and shareholder tax will not exceed the personal tax.

The Minister said the new rules would exclude the use of management companies to transform professional and other earnings into income qualifying for the small business tax incentive. Accordingly, where the principal purpose of a corporation is to provide administrative, managerial and similar services to a related business, the corporation's income will not qualify for the tax incentive.

While the small business tax deduction will not be available to these corporations, they will retain all the other advantages, including tax advantages, of incorporation.

DRAFT INCOME TAX REGULATION

Small Business Deduction

(1) For the purposes of sections 125 and 129 of the Act,

(a) "qualifying business" carried on by a corporation in a taxation year means any business other than a non-qualifying business, and

(b) "non-qualifying business" carried on by a corporation in a taxation year means

(i) the professional practice of an accountant, dentist, lawyer or medical doctor that is not permitted under the law of one or more provinces to be carried on by a corporation,

(ii) a business of providing services if more than 66 2/3% of the gross revenue for the year of that business derived from services

(A) is derived from services provided to, or performed for or on behalf of one entity, and

(B) can reasonably be attributed to services performed by persons who are specified shareholders of the corporation or persons related thereto unless the corporation employs in the business throughout the year more than five full-time employees who are not specified shareholders of the corporation or persons related thereto,

(iii) a business the principal purpose of which is to derive income from property including real property, shares, bonds, debentures, bills, notes, mortgages, hypothecs or similar obligations, unless the corporation employs in the business throughout the year more than five full-time employees who are not specified shareholders of the corporation or persons related thereto, and

(iv) a business the principal purpose of which is to provide managerial, administrative, financial, maintenance or other similar services to a business connected at any time in the year with the corporation.

(2) For the purposes of paragraph (1)(b),

(a) "business connected" at any time in a taxation year with a corporation means any business carried on by an individual, partnership or another corporation if at that time more than 50% of the shares of any class of the capital stock of the corporation are owned, directly or indirectly, by

(i) the individual,
(ii) members of the partnership, or
(iii) shareholders of the other corporation,

as the case may be, and for the purposes of this definition,

(iv) shares of the corporation owned by a person related to the individual referred to in subparagraph (i), a member of a partnership referred to in subparagraph (ii) or a shareholder referred to in subparagraph (iii) shall be deemed to be owned by that individual, member or shareholder, as the case may be, and not by the person who actually owned the shares, and

(v) a trust of which any person, individual, member or shareholder referred to in subparagraphs (i) to (iv) or any person related thereto is a beneficiary shall be deemed to be related to an individual referred to in subparagraph (i), a member of a partnership referred to in subparagraph (ii) or a shareholder referred to in subparagraph (iii), as the case may be.

(b) "entity" means a partnership, a person other than a member of a related group and one or more persons who are members of a related group, and

(c) "specified shareholder" of a corporation in a taxation year means a taxpayer who, owns, directly or indirectly, at any time in the year, not less than 10% of the issued shares of any class of the capital stock of the corporation and for the purposes of this definition a taxpayer shall be deemed to own a share owned by a person with whom he does not deal at arm's length.

3. For the purposes of subparagraph (1)(b)(ii), where a corporation was a member of a partnership at any time in a taxation year,

(a) there shall be included in the gross revenue for the year of a particular business carried on by the corporation in Canada, that proportion of the gross revenue of that business carried on in Canada by the partnership, for the fiscal period of the partnership coinciding with or ending in that year, that the corporation's share of the income of the partnership from that business for that fiscal period is of the income of the partnership from that business for that fiscal period, and

(b) clause (A) thereof shall be read as if the reference to "one entity" were a reference to "a number of entities that is not more than the number of members of the partnership at the end of the fiscal period of the partnership coinciding with or ending in that year".

4. For the purposes of subparagraph (1)(b)(iii), a particular corporation shall be deemed to employ in its business more than five full-time employees throughout a taxation year if any other corporation associated with it, or a corporation that carried on a business connected with it,

(a) provides managerial, administrative, financial, maintenance or other similar services to the particular corporation in the year, and

(b) can reasonably be expected to require more than the equivalent of five full time employees to provide those services.

Ontario

Ministry of the Attorney General

Professional Organizations Committee

102 Bloor Street West
Suite 320
Toronto, Ontario
M5S 1M8
416/965-2740

Chairman:
H. Allan Leal, Q.C.
Committee Members:
Dr. J. Alex Corry
Dr. J. Stefan Dupré
Research Director:
Professor Michael J. Trebilcock
Associate Directors:
Dr. Carolyn J. Tuohy
Dr. Alan D. Wolfson

This Working Paper is one of a series prepared for the Professional Organizations Committee:

#1 Donald N. Dewees, Stanley M. Makuch, Alan Waterhouse, An Analysis of the Practice of Architecture and Engineering in Ontario (1978)

#2 Michael Spence, Entry, Conduct and Regulation in Professional Markets (1978)

#3 Ellen B. Murray, Citizenship and Professional Practice in Ontario (1978)

#4 Peter Aucoin, Public Accountability in the Governing of Professions: A Report on the Self-Governing Professions of Accounting, Architecture, Engineering and Law in Ontario (1978)

#5 J. Robert S. Prichard, Incorporation by Professionals (1978)

#6 Thomas E. McDonnell, The Tax Implications of Permitting the Business of a Profession to be Carried on Through a Corporation in Ontario (1978); Robert Couzin, Memorandum on the November 16, 1978 Federal Budget (1978)

#7 John Quinn, Multidisciplinary Services: Organizational Innovation in Professional Service Markets (1978)

#8 Fred Lazar, J. Marc Sievers, Daniel B. Thornton, An Analysis of the Practice of Public Accounting in Ontario (1978)

#9 Edward P. Belobaba, Civil Liability as a Professional Competence Incentive (1978)

#10 Selma Colvin, David Stager, Larry Taman, Janet Yale, Frederick Zemans, The Market for Legal Services; Paraprofessionals and Specialists (1978)

#11 Barry J. Reiter,
Discipline as a Means of Assuring Continuing Competence in the Professions (1978)

#12 Ellen B. Murray,
Transfer of Professionals from Other Jurisdictions to Ontario (1978)

#13 Katherine Swinton,
The Employed Professional (1979)

#14 David Beatty and Morley Gunderson,
The Employed Professional (1979)

#15 John Swan,
Continuing Education and Continuing Competence (1979)

#16 Theodore Marmor and William White,
Paraprofessionals and Issues of Public Regulation (1979)

Copies are available for personal shopping at the Ontario Government Bookstore, 880 Bay Street, or by writing the Publications Centre, 880 Bay Street, 5th floor, Toronto, Ontario, M7A 1N8.

ISBN 0-7743-3412-6